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SECURITIES AND EXCHANGE COMMISSION
Washington

SECURITIES EXCHANGE ACT OF 1934
Release No. 1330

The Securities and Exchange Commission today announced the adoption of a comprehensive set of rules defining practices which are manipulative, deceptive or fraudulent in the over-the-counter markets and are therefore, in violation of the Securities Exchange Act of 1934, as amended. The rules apply to practices in the over-the-counter markets affecting all types of securities including those which are registered, unregistered or exempted from registration on a national securities exchange. Thus, the rules are applicable to those brokers and dealers, among others, who transact business exclusively in exempted securities, such as government, state and municipal bonds.

The rules in substance prohibit a broker or dealer from inducing the purchase or sale of any security by any act, practice or course of business which would defraud or deceive any person. A broker or dealer is also prohibited from inducing a purchase or sale by any untrue statement of a material fact or any omission to state a material fact, if the statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading. Misrepresentation as to the effect or meaning of registration as broker or dealer is likewise prohibited.

Before the completion of a transaction, the broker-dealer is required to give or send to the customer a written confirmation which discloses the capacity in which the broker-dealer is acting in the transaction. If he is acting as a broker, he must also disclose the name of the person on the other side of the transaction, as well as the date and time of the transaction or state that these facts will be furnished upon request. Further, in the case of a brokerage transaction, the confirmation must disclose the amount and source of all commissions or other remuneration received by the broker in connection with the transaction.

The completion of the transaction is defined to mean the time when the customer delivers the security being sold or pays for the security being purchased, or when the broker-dealer makes a bookkeeping entry showing the transfer of the security from the customer's account or the payment by the customer of the purchase price.

The Commission is giving further study to the feasibility of a rule requiring that a broker-dealer state to his customer whether he is acting as broker or as dealer before making any contract of purchase or sale for or with the customer.

A broker-dealer in a relationship of control with an issuer is required to disclose to the customer the existence of such relationship before he effects a transaction in any security of that issuer. This disclosure may be oral provided it is followed by written disclosure before the completion of the transaction. "Control" is a question of fact to be determined according to the circumstances of each particular case.

A broker who is financially interested in the primary or secondary distribution of a security or a dealer having such an interest and at the same time receiving a fee from the customer for giving investment counsel is required to give written notice to the customer of the existence of his interest before the completion of the transaction.

Further limitations, in addition to those just cited, are imposed on those brokers or dealers who trade for discretionary accounts. These limitations prohibit trading which is excessive either in size or frequency in view of the financial resources and character of the account. In trading for discretionary accounts, the broker-dealer is also required to make a record immediately after effecting any transaction for such an account which should include the name of the customer, the name, amount and price of the security and the date and time when the transaction took place. If the present record kept by a broker-dealer is in such form as to satisfy the requirements of the rule no additional record need be made. Such record must be preserved for a period of at least twelve months.

When a broker or dealer is engaged in the distribution of securities traded exclusively over-the-counter, restrictions are placed upon his offerings "at the market". In such a case, he is prohibited from representing that a security not admitted to trading on a national securities exchange is being offered "at the market" or at a price related to the market price, unless he has reasonable grounds to believe that a market for the security exists other than that made, created, or controlled by himself or his associates.

An important prohibition is designed to eliminate the practice of stimulating exchange activity in securities which are the subject of distribution. This rule prohibits any person engaged in distributing a security, whether or not he is a broker or dealer, from paying any other person for soliciting or inducing a third person to buy any security of the same issuer on an exchange. The rule, however, does not prohibit a broker-dealer from paying a salary to a person in his own regular employment whose ordinary duties include the solicitation or execution of brokerage orders on an exchange so long as the payment is not made to induce the purchase of a specific security.

In addition to other penalties provided by the Act, the violation of these rules occurring subsequent to their effective date will constitute grounds for the revocation or suspension of the registration of a broker or dealer.

The effective date of these rules is October 1, 1937.

The Securities and Exchange Commission, deeming it necessary for the execution of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 15(c) and 23(a) thereof, hereby adopts the following rules:

Rule MC1. *Definitions.* As used in any rule adopted pursuant to Section 15(c) of the Act:

- (a) The term "customer" shall not include a broker or dealer.
- (b) The term "the completion of the transaction" means:
 - (1) In the case of a customer who purchases a security through or from a broker or dealer, except as provided in paragraph (2), the time when such customer pays the broker or dealer any part of the purchase price, or, if payment is effected by a bookkeeping entry, the time when such bookkeeping entry is made by the broker or dealer for any part of the purchase price;
 - (2) In the case of a customer who purchases a security through or from a broker or dealer and who makes payment therefor prior to the time when payment is requested or notification is given that payment is due, the time when such broker or dealer delivers the security to or into the account of such customer;
 - (3) In the case of a customer who sells a security through or to a broker or dealer, except as provided in paragraph (4), if the security is not in the custody of the broker or dealer at the time of sale, the time when the security is delivered to the broker or dealer, and if the security is in the custody of the broker or dealer at the time of sale, the time when the broker or dealer transfers the security from the account of such customer;
 - (4) In the case of a customer who sells a security through or to a broker or dealer and who delivers such security to such broker or dealer prior to the time when delivery is requested or notification is given that delivery is due, the time when such broker or dealer makes payment to or into the account of such customer.

Rule MC2. *Fraud and Misrepresentation.* (a) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this rule shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to Section 15(c) of the Act.

Rule MC3. *Misrepresentation by Brokers and Dealers as to Registration.* The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any representation by a broker or dealer that the registration of a broker or dealer, pursuant to Section 15(b), or the failure of the Commission to deny or revoke such registration, indicates in any way that the Commission has passed upon or approved the financial standing, business, or conduct of such registered broker or dealer or the merits of any security or any transaction or transactions therein.

Rule MC4. *Confirmation of Transactions.* The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act of any broker or dealer designed to effect with or for the account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security unless such broker or dealer, at or before the completion of each such transaction, gives or sends to such customer written notification disclosing (1) whether he is acting as a broker for such customer, as a dealer for his own account, as a broker for some other person, or as a broker for both such customer and some other person; and (2) in any case in which he is acting as a broker for such customer or for both such customer and some other person, either the name of the person from whom the security was purchased or to whom it was sold for such customer and the date and time when such transaction took place or the fact that such information will be furnished upon the request of such customer, and the source and amount of any commission or other remuneration received or to be received by him in connection with the transaction.

Rule MC5. *Disclosure of Control.* The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act of any broker or dealer controlled by, controlling, or under common control with, the issuer of any security, designed to effect with or for the account of a customer any transaction in, or to induce the purchase or sale by such customer of, such security unless such broker or dealer, before entering into any contract with or for such customer for the purchase or sale of such security, discloses to such customer the existence of such control, and unless such disclosure, if not made in writing, is supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

Rule MC6. *Disclosure of Interest in Distributions.* The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act of any broker who is acting for a customer or for both such customer and some other person, or of any dealer who receives or has promise of receiving a fee from a customer for advising such customer with respect to securities, designed to effect with or for the account of such customer any transaction in, or to induce the purchase or sale by such customer of, any security in the primary or secondary distribution of which such broker or dealer is participating or is otherwise financially interested unless such broker or dealer, at or before the completion of each such transaction gives or sends to such customer written notification of the existence of such participation or interest.

Rule MC7. *Discretionary Accounts.* (a) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act of any broker or dealer designed to effect with or for any customer's account in respect to which such broker or dealer or his agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of such account.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any act of any broker or dealer designed to effect with or for any customer's account in respect to which such broker or dealer or his agent or employee is vested with any discretionary power any transaction of purchase or sale unless immediately after effecting such transaction such broker or dealer makes a record of such transaction which record includes the name of such customer, the name, amount and price of the security, and the date and time when such transaction took place.

Rule MCB. *Sales at the Market.* The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in Section 15(c) of the Act, is hereby defined to include any representation made to a customer by a broker or dealer who is participating or otherwise financially interested in the primary or secondary distribution of any security which is not admitted to trading on a national securities exchange that such security is being offered to such customer "at the market" or at a price related to the market price unless such broker or dealer knows or has reasonable grounds to believe that a market for such security exists other than that made, created, or controlled by him, or by any person for whom he is acting or with whom he is associated in such distribution, or by any person controlled by, controlling or under common control with him.

The Securities and Exchange Commission, deeming it necessary for the execution of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, and deeming the acts or practices hereinafter prohibited to be devices and contrivances which are manipulative and deceptive, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 10(b) and 23(a) thereof, hereby adopts the following rules:

Rule GB2. *Solicitation of Purchases on an Exchange to Facilitate a Distribution of Securities.* (a) No person, participating or otherwise financially interested in the primary or secondary distribution of any security of any issuer, shall, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

- (1) pay or offer or agree to pay, directly or indirectly, to any person any compensation for soliciting another to purchase any security of the same issuer on a national securities exchange, or for purchasing any security of the same issuer on any such exchange for any account other than the account of the person who pays or is to pay such compensation; or

- (2) sell, offer to sell or induce an offer to buy such security, or deliver such security after sale, if, in connection with such distribution, such person has paid, or has offered or agreed to pay, directly or indirectly, to any person, any compensation for soliciting another to purchase any security of the same issuer on any national securities exchange, or for purchasing any security of the same issuer on any such exchange for any account other than the account of the person who has paid or is to pay such compensation.

(b) No person, participating or otherwise financially interested in the primary or secondary distribution of any security of any issuer, shall cause a purchase or sale of any security of the same issuer on a national securities exchange by paying or offering or agreeing to pay, directly or indirectly, to any person any compensation for soliciting another to purchase such security on any such exchange, or for purchasing such security on any such exchange for any account other than the account of the person who pays or is to pay such compensation.

(c) The provisions of this rule shall not apply in respect to any salary paid by a broker or dealer to any person regularly employed by him whose ordinary duties include the solicitation or execution of brokerage orders on a national securities exchange, if such salary represents only ordinary compensation for the discharge by such person of such duties in the regular course of his employment, and is not paid, in whole or in part, directly or indirectly, for the inducement by such person of the purchase or sale on a national securities exchange of any security of the issuer of the security in the primary or secondary distribution of which such broker or dealer is participating or otherwise financially interested.

Rule GB3. *Employment of Manipulative and Deceptive Devices.* It shall be unlawful for any broker or dealer, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included with the term "manipulative, deceptive or other fraudulent device or contrivance", as such term is used in Section 15(c) of the Act.

The Securities and Exchange Commission, deeming it necessary for the execution of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 17(a) and 23(a) thereof, hereby adopts the following rule:

Rule OA1 - *Preservation of Records Under Rule MC7.* Every broker or dealer subject to the provisions of Section 15(c) shall keep and preserve for at least twelve months such records as such broker or dealer may be required to make pursuant to the provisions of Rule MC7.

The foregoing rules shall become effective October 1, 1937.