Part II

Information Required in the Registration Statement

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Item 8. Consultants and Advisors

Disclose the names of any consultants or advisors to whom securities will be issued pursuant to the registration statement. Specify the number of securities that will be issued to each of these persons pursuant to this registration statement. Describe the specific services provided to the registrant by each consultant or advisor that are compensated by securities registered on this registration statement.

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Dated: February 17, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–4459 Filed 2–24–98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–39670; File No. S7–3–98]

RIN 3235–AH40

Publication or Submission of Quotations Without Specified Information

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is publishing for public comment proposed amendments to Rule 15c2–11 (''Rule'') under the Securities Exchange Act of 1934 (''Exchange Act''). The Commission is publishing these proposals in response to increasing incidents of fraud and manipulation in the over-the-counter securities market involving thinly traded securities of thinly-capitalized issuers (*i.e.*, ''microcap securities''). Rule 15c2–11 governs the publication of quotations for securities that are traded in a quotation medium other than a national securities exchange or Nasdaq. The proposals would require all broker-dealers to review information about the issuer when they first publish or resume publishing a quotation for a security subject to the Rule, document that review, annually update the information if they publish priced quotations, and make the information available to other persons upon request. In addition, the proposals would enhance the Rule's information requirements for quotations for the securities of non-reporting issuers and ease the Rule's recordkeeping requirements when broker-dealers have electronic access to information about reporting issuers. The Commission also is proposing a number of textual and structural changes in an effort to simplify and streamline the Rule. Finally, the Commission is proposing an amendment to Rule 17a–4 under the Exchange Act that would incorporate the record retention requirements currently contained in Rule 15c2–11.

DATES: Comments must be received on or before April 27, 1998.

ADDRESSES: Persons wishing to submit written comments should send three copies to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Mail Stop 6–9, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–3–98; this file number should be included on the subject line if E-mail is used. Comment letters received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Any of the following attorneys in the Office of Risk Management and Control, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at (202) 942–0772: Nancy J. Sanow, Alan Reed, Irene Halpin, Florence Harmon, Denise Landers, or Chester McPherson.

SUPPLEMENTARY INFORMATION: The Commission is proposing for comment amendments to Rule 15c2–11 [1] and Rule 17a–4 [2] under the Securities Exchange Act of 1934 (''Exchange Act'').[3]

I. Executive Summary and Background

A. Executive Summary

Incidents involving fraud and manipulation of microcap securities that trade in the over-the-counter (''OTC'') securities market appear to be rising.[4] This trend has been the subject of Congressional hearings,[5] state hearings [6] and numerous media reports.[7] These developments have caused the Commission to reexamine Exchange Act Rule 15c2–11, its rule governing the publication of quotations in the non-Nasdaq OTC market. As a result, the Commission is proposing comprehensive amendments to Rule 15c2–11 that address abuses involving microcap securities and more generally would enhance the integrity of quotations for securities in this market sector. The proposed amendments also would reorganize and simplify the Rule's provisions.

Microcap securities [8] generally are characterized by low share prices and little or no analyst coverage. The issuers of microcap securities typically are thinly capitalized and often are not required to file periodic reports with the Commission. Securities of microcap companies usually are quoted on the OTC Bulletin Board (''Bulletin Board'') operated by the National Association of Securities Dealers, Inc. (''NASD'') or in the Pink Sheets published by the National Quotation Bureau (''NQB''), but they are not exclusive to these

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[1] 17 CFR 240.15c2–11.

[2] 17 CFR 240.17a–4.

[3] 15 U.S.C. 78a *et seq.*

[4] See, *e.g.*, *M. Rimson & Co., Inc.*, 1997 WL 93628 (February 25, 1997) (Initial Decision); (Securities Exchange Act Release No. 38489 (April 9, 1997) (Finality Order)); *See also, SEC* v. *Jeffrey Szur,* No. 97 Civ. 9305 (S.D.N.Y. December 18, 1997); *SEC* v. *George Badger,* No. 97 CV 963K (D. Utah December 18, 1997); *SEC* v. *Andrew Scudiero,* No. 97 Civ. 9304 (S.D.N.Y. December 18, 1997); *SEC* v. *Leonard Alexander Ruge,* No. 97 Civ. 9306 (S.D.N.Y. December 18, 1997); *SEC* v. *Joseph Pignatiello,* No. 97 Civ. 9303 (S.D.N.Y. December 18, 1997). For a summary of the SEC's allegations in these cases, see Litigation Release No. 15595 (December 18, 1997), 1997 SEC LEXIS 2602.

[5] See United States Senate Committee on Governmental Affairs Permanent Subcommittee on Investigations, Hearing on Fraud in the Micro Capital Market (September 22, 1997) (testimony of Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission) (''Senate Testimony on Microcap Fraud'').

[6] N.Y. Attorney General, REPORT ON MICRO-CAP FRAUD (December 1997).

[7] See, *e.g.*, Weiss, ''Investors Beware—Chop Stocks Are on the Rise,'' Business Week, December 15, 1997, at 112–128; Lohse and Emshwiller, ''Bulletin Board Likely to Remain Wild West of Wall Street,'' The Wall Street Journal, December 15, 1997, at C1; Schroeder, ''Despite Reforms, Penny-Stock Fraud is Roaring Back,'' The Wall Street Journal, September 4, 1997, at A12; Byrne, ''The Real OTC Market: The Spectacular Success of Pink Sheet and Bulletin Board Trading: Why the NASD is Toughening Standards,'' Traders, September 1997, at 36–39; Lohse, ''Fraud by Small-Stock Operators Flourishes in Long Bull Market,'' The Wall Street Journal, July 31, 1997, at C1.

[8] The term ''microcap securities'' is not defined under the federal securities laws or regulations. The use of the term ''microcap securities'' in this release, however, should be distinguished from its use in the mutual fund context. For example, Lipper Analytical Services, a mutual fund rating organization, generally categorizes microcap companies as companies with market capitalization of less than $300 million. Lipper-Directors' Analytical Data, Investment Objective Key, 2d ed. 1997.

mediums.[9] The Commission recognizes, however, that not all securities traded in this market sector are tainted by fraud.

Microcap fraud frequently involves issuers for which public information is limited, especially when issuers are not subject to reporting requirements.[10] Without information, it is difficult for investors, securities professionals, and others to evaluate the risks presented by microcap securities. Investors consequently can fall prey to persons who make false representations and unrealistic predictions about these securities.

As part of their manipulative schemes, unscrupulous retail brokers, operating out of ''boiler rooms,'' frequently use high pressure sales tactics to stimulate investors to buy these securities. These brokers often publicly disseminate false press releases or make false statements about issuers (including through the Internet) to promote sales. To further the manipulative scheme, retail broker-dealers often also act as market makers or, either on their own or through the issuers' promoters, induce other firms to act as market makers in the securities.

Market makers' quotations are important to the success of microcap fraud schemes. By publishing quotations in the Bulletin Board, in the Pink Sheets, or in similar quotation mediums, broker-dealers give the market for the securities an aura of credibility. This can occur even if the market maker is not intentionally participating in improper activities, but is publishing quotes in response to escalating demand for the securities resulting from increasing retail sales. Trading volume for the security skyrockets and quotations and sales prices escalate (often at prices artificially set by the manipulators).

Eventually, broker-dealers and promoters stop stimulating interest in the security and its price drops. Too often the result is the same: innocent investors lose money. To address this microcap fraud problem, the Commission is pursuing a strategy of investor education, focused broker-dealer inspections, increased enforcement, and regulatory initiatives.[11]

The proposed amendments to Rule 15c2–11 would place greater information review and recording requirements, and thus greater accountability, on broker-dealers publishing quotations for securities in a quotation medium other than a national securities exchange or Nasdaq (''covered OTC securities''). These proposed amendments also would provide greater investor access to information about these securities. In particular, the proposed amendments would:

- Eliminate the Rule's ''piggyback'' provision, which currently permits broker-dealers (other than the initial broker-dealer) to quote the security without having current issuer information;
- Require broker-dealers that publish priced quotations for a security to obtain and review updated information about the issuer at least annually;
- Expand the information required about issuers that do not file periodic reports with the Commission;
- Require documentation of the broker-dealer's compliance with Rule 15c2–11; and
- Enhance investor access to the information required by Rule 15c2–11.

The proposed amendments apply to all securities covered by Rule 15c2–11, not just microcap securities. The Commission believes that the scope of the amendments is appropriate to preserve the general integrity of quotations in the OTC market and to foster greater information transparency in a marketplace where issuers often are relatively unknown and their securities are traded infrequently.

B. Operation of Current Rule 15c2–11

Rule 15c2–11 regulates the initiation and resumption of quotations in a quotation medium by a broker-dealer for certain OTC securities. The Commission adopted Rule 15c2–11 in 1971 to prevent fraudulent and manipulative trading schemes that had arisen in connection with the distribution and trading of unregistered securities issued by ''shell'' companies, or other issuers of infrequently-traded securities (about which there was little public information).[12] The Rule prevents broker-dealers from publishing quotations for covered OTC securities without reviewing basic information about the issuer.[13] Specifically, the Rule applies to broker-dealers publishing quotations in a ''quotation medium,''[14] but it does not apply to broker-dealers publishing quotations for securities listed and traded on an exchange or quoted on Nasdaq.

Subject to certain exceptions, the Rule prohibits a broker-dealer from publishing a quotation for a security (or submitting a quotation for publication) in a quotation medium unless it has obtained and reviewed specified information about the issuer and the security. The broker-dealer also must have a reasonable basis for believing that the issuer information is accurate and that it was obtained from a reliable source.

Currently, a broker-dealer must review and maintain in its records the following issuer information:

- For an issuer that has conducted a recent public offering either registered under the Securities Act of 1933 (''Securities Act'')[15] or effected pursuant to Regulation A under the Securities Act, a copy of the prospectus or offering circular;
- For an issuer that files reports with the Commission pursuant to Sections 13 or 15(d) of the Exchange Act (''reporting issuer'') or is an insurance company of the kind specified in Section 12(g)(2)(G) of the Exchange Act, the issuer's most recent annual report and any quarterly or current reports filed thereafter;
- For foreign issuers that claim the registration exemption under Exchange Act Rule 12g3–2(b), the information furnished to the Commission pursuant to that rule; or
- For any other issuer, the information, including certain financial information, specified in paragraph (a)(5) of the Rule, which must be reasonably current in relation to the day a quotation is submitted.

In addition, paragraph (c) of the Rule requires a broker-dealer to review any other information about the issuer that comes to its knowledge or possession before the publication or submission for publication of a quotation.

Under the Rule's ''piggyback'' exception, the information requirements do not apply when a broker-dealer publishes, in an interdealer quotation system,[16] a quotation for a covered OTC

[9] Microcap securities can also be listed on securities exchanges or Nasdaq.

[10] See *e.g., SEC* v. *Global Financial Traders, Ltd.*, Litigation Release Nos. 15291 (March 14, 1997) and 15338 (April 17, 1997); see also infra note 73.

[11] In addition, the NASD recently published for comment several proposed rules aimed at microcap stock abuses. These proposals would limit quotations on the OTC Bulletin Board to the securities of issuers that file reports with the Commission or other regulatory authority, and would require NASD members to review current issuer financial statements prior to recommending a transaction to a customer in an OTC equity security (other than securities listed on Nasdaq or an exchange) and to deliver a disclosure statement to a customer prior to an initial purchase of an OTC equity security. NASD Notices to Members 98–14 and 98–15 (January 1998).

[12] Securities Exchange Act Release No. 9310 (September 13, 1971), 36 FR 18641.

[13] See Securities Exchange Act Release No. 29094 (April 17, 1991), 56 FR 19148 (''1991 Adopting Release''); Securities Exchange Act Release No. 29095 (April 17, 1991), 56 FR 19158 (''1991 Proposing Release'').

[14] See 17 CFR 240.15c2–11(e)(1) (defining *quotation medium* as any *interdealer quotation system* or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell).

[15] 15 U.S.C. 77a *et seq.*

[16] An *interdealer quotation system* is a quotation medium of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers. 17 CFR 240.15c2–11(e)(2).

security that already has been the subject of regular and frequent quotations.[17] A broker-dealer can''piggyback'' on either its own or other broker-dealers' previously published quotations. The exception is grounded on the assumption that regular and frequent quotations for a security generally reflect market supply and demand forces based on independent, informed pricing decisions.

C. 1991 Proposing Release

In 1991, the Commission proposed amendments to Rule 15c2–11 that would have eliminated the piggyback provision. At the time, the Commission believed that the underlying assumption of the piggyback provision (*i.e.*, that regular and frequent quotations for a security generally reflect supply and demand forces based on independent pricing decisions) were no longer valid in the non-Nasdaq OTC market.[18]

The Commission observed that the Rule's coverage is limited to non-Nasdaq OTC securities, which usually are low-priced, speculative stocks of relatively unknown issuers, and that the market for these securities is characterized by an absence of both market making and retail competition. As a result, the Commission proposed amendments that would have required every broker-dealer to review issuer information prior to initiating or resuming quotations in a covered OTC security. These amendments would have retained a ''self-piggybacking'' provision for broker-dealers that quoted these securities with the required frequency.[19]

The Commission received 75 comment letters from 74 commenters in response to the 1991 Proposing Release. The vast majority of commenters opposed the Commission's proposal. These commenters believed that the proposal would discourage, or even eliminate, market making for many non-Nasdaq OTC securities. They claimed that the proposed amendments would have impaired liquidity, reduced market value, and harmed the capital-raising process. Several commenters believed that the proposed changes would have hurt the market for the securities of many substantial and legitimate companies, but would have little effect on fraud in worthless stocks. For several reasons, including the adoption of other measures aimed at curbing then-existing abuses in low-priced stocks,[20] the Commission did not take further action on this initiative.[21]

II. Proposed Amendments

A. Proposed Revisions to Rule 15c2–11

1. Activities Prohibited by the Rule

The proposed amendments restructure Rule 15c2–11 to set forth more clearly the activities prohibited by the Rule and the requirements of the Rule. The Rule would state that it is unlawful for a broker-dealer, directly or indirectly, to publish or to submit for publication any quotation for a security in any quotation medium unless the broker-dealer complies with the Rule's provisions.[22]

The Rule further would provide that, prior to publishing or submitting for publication an initial quotation for a security in a quotation medium, or upon the occurrence of enumerated events, a broker-dealer must:

- Obtain and review the Rule's information;
- Determine that it has a reasonable basis for believing that the information is accurate and current in all material respects and is obtained from reliable sources; and
- Record the date it reviewed the specified information, the sources of the information, and the person at the firm responsible for the broker-dealer's compliance with the Rule.[23]

By restructuring the Rule in this manner, the Commission believes that the obligations of broker-dealers under the Rule are more clearly set out. Moreover, by imposing a recordation requirement, broker-dealers' accountability for compliance with the Rule should be enhanced.

Q1. Do the Rule's core requirements remain appropriate or should they be amended?

Q2. Are there other compliance items that should be recorded?

Q3. Should the Rule expressly require the firm's compliance officer to review the Rule 15c2–11 information before the quote is submitted?

Q4. What type of review do broker-dealers currently undertake? What is the appropriate scope of review by a broker-dealer to comply with the Rule, as proposed to be amended? Commenters should consider the duties of a broker-dealer under Rule 15c2–11 as discussed in the 1991 Adopting Release.[24]

2. Elimination of the Piggyback Provision

The Commission proposes to eliminate the piggyback provision. As discussed above, the piggyback provision currently permits broker-dealers to publish quotations for a security without complying with the Rule's requirements if any other broker-dealer has published regular and frequent quotations for that security. In the Commission's view, microcap fraud is facilitated by broker-dealers that publish quotations for a security without reviewing any issuer information.[25] Even if they are not participating in the fraud, these other broker-dealers give the security a measure of credibility through their quotations. Some broker-dealers claim that they ''trade by the numbers'' (*i.e.*, they trade solely on the basis of supply and demand factors and without regard to fundamental information about the issuer).[26] The Commission believes that eliminating the piggyback provision is an essential step to preventing microcap fraud. In the Commission's view,

[17] 17 CFR 240.15c2–11(f)(3). The security must have been the subject of quotations on at least 12 business days during the previous 30 calendar days, with no more than 4 consecutive business days elapsing without a quotation. Once this quotation frequency is established, a broker-dealer may publish a quotation for a covered security without having the required information if the 12 and 4 day tests are satisfied.

[18] 1991 Proposing Release, 56 FR at 19161.

[19] See 1991 Proposing Release. *Self-piggybacking* refers to the ability of a broker-dealer to continue publishing quotations without reviewing the Rule's required information, as long as that broker-dealer satisfies the quotation frequency tests of the piggyback provision.

[20] See Securities Exchange Act Release No. 30608 (April 20, 1992), 57 FR 18004 (adopting the Commission's Penny Stock Disclosure Rules (17 CFR 240.3a51–1, 240.15g–1 through 240.15g–6, 240.15g–8, and 240.15g–100)); see also Securities Exchange Act Release No. 32576 (July 2, 1993), 58 FR 37413 (redesignating Rule 15c2–6 under the Exchange Act as Rule 15g–9 under the Exchange Act (17 CFR 240.15g–9)).

[21] In light of the present proposals, the Commission is withdrawing the 1991 proposals.

[22] Rule 15c2–11 generally applies to the publication or submission for publication of quotations for OTC securities that do not satisfy any of the exceptions under the Rule. The exceptions are discussed in Section A.5, *infra*.

[23] See 1991 Adopting Release, 56 at 19150 (discussing of the nature of the review that a broker-dealer must conduct to satisfy its obligations under Rule 15c2–11 and the determination of whether the source of the information is reliable).

[24] *Id*.

[25] See General Bond & Share Co., 51 S.E.C. 411 (1993) *aff'g Market Surveillance Committee* v. *General Bond & Share Co.*, 1992 NASD Discip. Lexis 99 (January 30, 1992), *affirmed in part, vacated in part, and remanded*, 39 F.3d 1451 (10th Cir. 1994). In this case, the Commission affirmed a decision of the NASD's National Business Conduct Committee Securities Dealers (''NBCC''), which found that General Bond & Share Co. (''General Bond''), a registered broker-dealer, violated Article III, Section 1 of the NASD's Rules of Fair Practice by accepting issuer-paid compensation for listing itself as a market maker in the Pink Sheets for the securities of numerous issuers. The NBCC also found that General Bond's Pink Sheet entries paved the way for other market makers to piggyback onto those quotations without complying with the requirements of Rule 15c2–11.

[26] *See* D.H. Blair & Co., 44 S.E.C. 320, 332 (1970) (trading by the numbers cannot be completely separated from the investment value of the security or the need for supervision with a view to detecting possible signs of manipulation).

responsible broker-dealers would be deterred from publishing quotations if they were aware of basic information about the issuer that suggested a possible fraud.

Under the proposal, each broker-dealer that publishes a quotation for a covered OTC security for the first time in a particular quotation medium [27] other than the exchanges or Nasdaq would be required to review fundamental information about the issuer and have a reasonable basis for believing that the information is accurate, current, and from reliable sources. The Commission recognizes that many commenters on the 1991 Proposing Release raised issues about the perceived costs of compliance and the possible resulting loss of liquidity for some securities if the piggyback provision were eliminated and annual information updating were required. As discussed below, the availability of the EDGAR system should reduce the information gathering and recordkeeping costs for those broker-dealers that publish quotes for the securities of reporting issuers. Also, the Commission encourages the development of central repositories of information about issuers that are not participating in its public disclosure system.[28]

Q5. Are there any circumstances in which it would be appropriate to retain a piggyback provision? If so, how should such a provision be structured?

3. The Occurrence of Events Requiring Actions under the Rule

After a broker-dealer publishes its first quotation [29] in compliance with the Rule for a security in a particular quotation medium it can continue to publish quotations (either priced or unpriced) for the security in that medium without reviewing updated information until the occurrence of either of the following events:

- A period of five or more consecutive business days in which the broker-dealer does not publish quotations for the security; or
- The Commission has ordered a trading suspension pursuant to Section 12(k) [30] of the Exchange Act for any of the issuer's securities.

Following one of these events, a broker-dealer must gather and review the information required by the Rule before publishing quotations. In the Commission's view, if a broker-dealer has not quoted the security for five or more consecutive business days, that fact may reflect the broker-dealer's nominal interest in publishing quotations for the security, and thus the broker-dealer may not be aware of significant events involving the issuer.

The Rule also would require a broker-dealer to gather and review the specified information annually if the broker-dealer publishes priced quotations for the security. The purpose of this requirement is to make sure that a broker-dealer publishing priced quotations periodically reviews fundamental information about the issuer. A broker-dealer should know if there is no current information about the issuer or if the current information reflects a significant change in the issuer's ownership, operations, or financial condition.

The annual update requirement would apply only to broker-dealers publishing priced quotations. The Commission believes that priced quotations have been used in microcap fraud and manipulation schemes, (*e.g.*, when a broker-dealer publishes quotations at increasing prices to obtain bank loans or to value customer securities' positions). In addition, priced quotations are used as indicia of value for a variety of purposes (*e.g.*, pledges of securities). The Commission will reconsider its position, however, if it discovers that unpriced entries are also used to facilitate unlawful schemes.

The broker-dealer would have two optional dates as measuring points for conducting the annual review: the anniversary date of its initial quotation for the security; or the date that is four months after the end of the issuer's fiscal year (or, for a foreign private issuer, the date that is seven months after the end of the issuer's fiscal year). The annual review must be conducted before the broker-dealer publishes a priced quotation following the review date option that it selects. The Commission believes that four months (or seven months for foreign private issuers) would give a broker-dealer sufficient time to obtain and review updated issuer information about reporting and non-reporting issuers.

Q6. Should the annual update requirement apply to unpriced quotations?

Q7. Should the annual update requirement be eased or eliminated when a reporting issuer is current in its Exchange Act reporting obligations?

Q8. Should the provision triggering the review of updated information following a break in quotations provide for a period of more or less than five consecutive business days?

Q9. In addition to a trading suspension, should any other significant events involving the issuer (*e.g.*, a merger or acquisition, significant offering, name change, change of business, resignation of accountants, or bankruptcy proceeding) trigger the Rule's obligations to obtain, review, and document updated information?

Q10. Should the Rule include other optional dates triggering the annual review requirement for priced quotations (*e.g.*, by January 1 of each year)?

Q11. For domestic issuers, should the period within which a broker-dealer must conduct an annual review be longer than four months after an issuer's fiscal year end (for example, five or six months) or shorter than four months (for example, three months, or 14 weeks)?

Q12. For foreign issuers, should the period within which a broker-dealer must conduct an annual review be longer than seven months after an issuer's fiscal year end (for example, as long as nine months) or shorter than seven months (for example, four or six months)?

Q13. For foreign issuers, should the annual updating requirement apply if trading is suspended on any exchange or organized market on which its securities trade?

Q14. Would either the requirement to review updated information after a five-day lapse or the annual update requirement adversely affect the liquidity of covered OTC securities? Commenters responding to this question are urged to provide data and analysis.

4. Information Required by the Rule

a. Issuer Information. Current Rule 15c2–11 specifies the information that a broker-dealer must review before publishing quotations for five categories of issuers: (1) Issuers that had a recent registered offering; (2) issuers that had a recent offering under Regulation A under the Securities Act;[31] (3) reporting issuers and insurance companies

[27] See Section C, *infra*, for a discussion of the definition of quotation medium.

[28] See Section D, *infra*.

[29] The term *quotation* is defined as any bid or offer at a specified price with respect to a security, or any indication of interest by a broker or dealer in receiving bids or offers from others for a security, or any indication by a broker or dealer that advertises its general interest in buying or selling a particular security. For the purposes of this release, a ''priced quotation'' is a bid or offer at a specified price and an ''unpriced quotation'' is any indication by a broker or dealer in receiving bids or offers from others or any indication by a broker or dealer that advertises its general interest in buying or selling a particular security.

[30] 15 U.S.C. 78*l*(k).

[31] Regulation A provides an exemption from registration under the Securities Act for offerings not exceeding $5 million, less the aggregate offering price of any other Regulation A offering during the prior 12 months. 17 CFR 230.251–230.263.

exempted from Section 12(g) of the Exchange Act[32] by reason of Section 12(g)(2)(G) (''exempt insurance companies'');[33] (4) foreign private issuers that are exempt from Section 12(g) of the Exchange Act by reason of compliance with Rule 12g3–2(b) thereunder;[34] and (5) other issuers. The proposals would revise the Rule's information requirements with respect to reporting issuers and would enhance the requirements for non-reporting issuers. In addition, the proposals would add an information provision that covers certain non-reporting financial institutions.

i. Reporting issuers and exempt insurance companies. Currently, a broker-dealer publishing quotations for the securities of a reporting issuer (or exempt insurance company) must review the issuer's most recent annual report, together with any subsequently filed quarterly or current reports. The proposed amendments retain this requirement and clarify that the issuer must be current in its reporting obligations. Therefore, broker-dealers publishing quotations for the securities of any issuer delinquent in its reporting obligations (''delinquent issuer'') no longer would be able to rely on the Rule's provision containing the information requirements designed for non-reporting issuers.[35]

For reporting issuers, broker-dealers would be able to access and review the required information on the Commission's EDGAR system, available through the Commission's Internet website (http://www.sec.gov). Broker-dealers using this method would have to document the date of their review and satisfy the Rule's information retention requirements, discussed later in this release.

Under the proposals, a broker-dealer could not publish its initial quote without reviewing the Rule's required information, nor could it continue to publish priced quotations without updating that information annually. This means that, in the case of a delinquent issuer, a broker-dealer would not be permitted to publish an initial quotation or continue to publish *priced* quotations after the annual review date because it would not be able to obtain current reports. Broker-dealers that initiated a quotation in compliance with the Rule prior to the issuer's delinquency could continue to publish *unpriced* quotations after the annual review date.

While the market for a delinquent issuer's securities may be somewhat constrained by this proposal, this requirement furthers the Rule's purpose of limiting the fraudulent and manipulative potential of priced quotations in the absence of accurate and current information about the issuer. The Commission recently brought several enforcement actions against issuers for failure to file timely reports.[36] In many of these actions, an active trading market for the issuer's securities existed even though adequate and current issuer information was not available to broker-dealers or investors. In these circumstances, priced quotations have a substantial potential to facilitate improper retail sales practices where broker-dealers recommend securities to investors, without adequate information to support the recommendation, and refer investors to the market price (*i.e.*, priced quotes) as an indication of value.

In the past, commenters have suggested marking the quotation with a designator to indicate that issuer information was not available.[37] The Commission does not view this alternative as responding adequately to the problem of active trading facilitated by priced quotations without current information. Moreover, that approach would remove an incentive that delinquent issuers may have to provide current information to their shareholders and the marketplace.

Q15. Under what circumstances, if any, should broker-dealers be able to initiate quotations, or continue publishing priced quotations, for the securities of delinquent issuers?

ii. Other issuers. Rule 15c2–11(a)(5)[38] specifies the information that broker-dealers must obtain and review for issuers other than those covered by paragraphs (a)(1) through (a)(4). For the most part, this provision covers the securities of U.S. non-reporting issuers. Currently, a broker-dealer is required to review basic information about these issuers, including: the issuer's most recent balance sheet, profit and loss, and retained earnings statements; a description of the issuer's business, products or services offered, and facilities; and a description of any relationship between the broker-dealer and the issuer's insiders.

Based on recent experience, broker-dealer review of additional items of information should reduce the potential for fraud in this segment of the capital market.

Therefore, the Commission proposes to expand the information that broker-dealers must review before publishing a quotation for a non-reporting issuer's securities and to make that information more readily available to the marketplace.

The proposed amendments would require broker-dealers to review more information about the issuer's outstanding securities, its officers and directors, its financial condition, and certain significant events, among other items. This enhanced information would give a broker-dealer that is considering whether to publish quotations a greater understanding of the issuer's operations and a better indication of whether potential or actual fraud or manipulation may be present.

Securities Information. The Rule would require a broker-dealer to obtain and review information regarding each class of the non-reporting issuer's outstanding securities, including the number of securities outstanding, the number of securities issuable upon exercise or conversion of outstanding derivative securities of the issuer, and the total number of securityholders of record as of the end of the issuer's most recent fiscal year (or a more recent date if the data is available). The Commission believes that this information is relevant because it provides broker-dealers with a greater awareness of the issuer's equity structure, particularly as recent incidents of fraud have involved transactions in derivative securities,

[32] 15 U.S.C. 78*l*(g).

[33] 15 U.S.C. 78*l*(g)(2)(G).

[34] 17 CFR 240.12g3–2(b).

[35] Currently, a broker-dealer can rely on paragraph (a)(5) of the Rule pertaining to non-reporting issuers when a report or statement of a reporting issuer or exempt insurance company is not ''reasonably available'' (*i.e.*, not on file with the Commission). 17 CFR 240.15c2–11(a)(5). See e.g., Robin Rushing, [1995–1996] Fed. Sec. L. Rep. (CCH) ¶ 85,731 (Initial Decision), Securities Exchange Act Release No. 36910 (February 29, 1996) (Finality Order) (where the company was delinquent in Exchange Act filing, the market maker was required to obtain paragraph (a)(5) information to comply with Rule 15c2–11).

[36] *SEC* v. *Wincanton*, No. 96–CV–02152 (D.D.C. September 17, 1996) (Litigation Release No. 15052 (D.D.C. September 17, 1996)); *SEC* v. *Equity AU, Inc.*, 96–CV–01775 (D.D.C. July 30, 1996)(Litigation Release No. 14993 (July 30, 1996)); *SEC* v. *Cayman Resources*, 96–CV–00968 (D.D.C. July 24, 1996) (Litigation Release No. 14996 (D.C.C. July 31, 1996; *SEC* v. *American Cascade*, 96–CV–00626 (D.D.C. March 29, 1996) (Litigation Release No. 14857 (March 29, 1996)); *SEC* v. *Parallel Technologies, Inc.*, 96–CV00545 (D.D.C. March 19, 1996) (Litigation Release No. 14848 (March 20, 1996)).

[37] In response to the 1991 Proposing Release, 17 commenters suggested some form of special designation indicating the broker-dealers's lack of required information. See, *e.g.*, Letter dated February 24, 1992, from Stephen D. Hickman, Secretary, NASD, to Jonathan G. Katz, Secretary, SEC (''1992 NASD Letter''), p.7.

[38] 17 CFR 240.15c2–11(a)(5).

such as warrants.[39] This enhanced information requirement would indicate to the broker-dealer whether any persons had access to large quantities of securities that could dilute the value of the public float.

Q16. Are there other items of information regarding the issuer's outstanding securities that would be helpful to broker-dealers publishing quotations of covered OTC securities?

Control Person Information. For non-reporting issuers, the Rule would require broker-dealers to obtain the names, addresses, and holdings in the issuer's securities of the issuer's insiders (including promoters and control persons), and information about the disciplinary histories of the issuer's insiders (including promoters and control persons). Specifically, the broker-dealer must review information about the following events involving persons related to the issuer in: Any criminal charges or convictions; any court-issued injunctions, bars or other limitations involving any type of business, securities, commodities, or banking activities; any violation of federal or state securities or commodities law; or any bars or suspensions by a self-regulatory organization (''SRO''). This information must be provided if the events occurred during the five-year period preceding the publication of the quotation. Reviewing these items of information should help broker-dealers evaluate the degree of control over the issuer exerted by insiders and alert the broker-dealer to possible ''red flags'' regarding the issuer's insiders and control persons.

Two alternative options for the broker-dealer to satisfy this requirement are proposed. The broker-dealer could obtain a statement from the issuer that none of the specified actions had occurred; or the broker-dealer could document the steps taken to obtain the required information and the issuer's response, including whether the issuer refused to cooperate. The second alternative would allow the broker-dealer to publish quotations when it has difficulty obtaining the information. However, the broker-dealer should consider the issuer's refusal to supply this information when the broker-dealer ascertains whether it has a reasonable basis for believing that the other Rule 15c2–11 information it obtained and reviewed is accurate and the sources are reliable.

Q17. Is it appropriate to allow a broker-dealer to publish quotations if the issuer refuses to supply disciplinary history information regarding its insiders, control persons, or promoters?

Q18. Should any other disciplinary history or other background information about the issuer's insiders, control persons, or promoters be required? Would this information be helpful to broker-dealers in determining whether to publish quotations?

Financial Information. The Commission is proposing to expand the financial information that a broker-dealer must gather and review about a non-reporting issuer. The proposal includes different requirements with respect to domestic and foreign private issuers. Currently, paragraph (a)(5)(xii) requires a broker-dealer to obtain and review an issuer's most recent balance sheet and profit and loss and retained earnings statements. The Rule does not require this financial information to be audited or presented in a particular format.

Domestic non-reporting issuers. The proposed amendments would require a broker-dealer to obtain and review the issuer's most recent balance sheet, statement of operations (income), statement of cash flows, statement of shareholders' equity, and statement of comprehensive income. It also would require these items to be prepared in accordance with U.S. generally accepted accounting principles (''U.S. GAAP''). This requirement for the financial statements to be prepared in accordance with a comprehensive body of generally accepting accounting principles would create greater uniformity for these financial statements. This uniformity would assist the review by broker-dealers and surveillance by regulators.

The Commission understands that in the case of non-reporting U.S. issuers, the financial statements submitted on NASD Form 211 to the NASD pursuant to NASD Marketplace Rule 6740 typically are prepared in accordance with U.S. GAAP and some, but not all, are audited.[40] Accordingly, the Commission's preliminary view is that the proposed U.S. GAAP standard would not impose substantial costs on issuers.

Q19. Do most domestic non-reporting issuers already prepare their financial statements in accordance with U.S. GAAP?

Q20. Should the Rule require that these financial statements be audited?

Foreign non-reporting issuers. The proposals would require a broker-dealer to obtain and review the following information for a foreign private issuer (other than an issuer furnishing information to the Commission pursuant to Rule 12g3–2(b)): the issuer's most recent balance sheet and statement of operations (income) and, to the extent prepared by the issuer, statements of cash flows, comprehensive income and changes in shareholders' equity. These statements must be prepared in accordance with a comprehensive body of accounting principles. This proposal would provide broker-dealers with financial information about issuers that do not participate in the Exchange Act reporting programs. Preparation of U.S. GAAP financial statements would be permitted but not required.

The proposal would permit broker-dealers to obtain information prepared using a number of different comprehensive bodies of accounting which will limit the uniformity of the information reviewed. Although the Commission has not included specific amendments to address this concern, the Commission is seeking comments on possible alternative measures that could be adopted to improve the level of financial information relied upon by broker-dealers when submitting priced quotations for foreign non-reporting issuers' securities.

Q21. The proposal requires a broker-dealer to obtain and review statements of cash flows, comprehensive income and changes in shareholders' equity only to the extent prepared by the issuer. Should broker-dealers be prohibited from publishing quotations if certain of those financial statements are not available? If so, which ones should be required?

Q22. Do most foreign non-reporting issuers already prepare their financial statements in accordance with a comprehensive body of accounting principles?

Q23. Should broker-dealers be required to obtain and review financial statements for foreign non-reporting issuers prepared in accordance with or that are reconciled to U.S. GAAP?[41]

Q24. Should broker-dealers be required to obtain and review financial statements for foreign non-reporting issuers prepared in accordance with or reconciled to U.S. GAAP[42] only when the principal market for their securities is the United States?

[39] See Michael J. Markowski, Securities Exchange Act Release No. 38424 (March 20, 1997) (instituting an administrative proceeding alleging manipulation in connection with the initial public offering of units made up of common stock and warrants of three different issuers); Securities Exchange Act Release No. 38425 (March 20, 1997) (order of settlement).

[40] See NASD Manual, Marketplace Rules, Rule 6740.

[41] Requirements for quantitative and qualitative reconciliations of non-U.S. GAAP financial information to U.S. GAAP are specified in Items 17 and 18 of Form 20–F. 17 CFR 249.220F.

[42] *Id*.

Q25. Should the Rule require that these financial statements be audited? If so, should they be required to be audited in accordance with U.S. generally accepted auditing standards?

Significant Events. In addition, the proposals would require a description of significant events regarding the issuer during the last two years, including: A change in control; a 10% or more increase in an outstanding class of equity securities; a merger or acquisition; an acquisition or disposition of significant assets; bankruptcy proceedings; or delistings by a securities exchange or Nasdaq. This information seems relevant because broker-dealers would be made aware of information about significant events involving the issuer. The Commission is also proposing to add a provision, similar to the disciplinary history requirement, that would give broker-dealers the alternative of either obtaining a statement from the issuer that none of these events had occurred or providing its own statement of the steps it took to obtain the significant event information in cases where the issuer failed or refused to provide it.

Q26. Are there other significant events involving the issuer that a broker-dealer should review before publishing a quotation?

Q27. Is it appropriate to allow a broker-dealer to publish quotations if the issuer refuses to provide information regarding a significant event?

iii. Certain foreign issuers. Rule 15c2–11 [43] currently permits a broker-dealer to obtain and review the information submitted to the Commission by a foreign private issuer pursuant to Rule 12g3–2(b) under the Exchange Act.[44] Rule 12g3–2(b) exempts securities of any foreign private issuer from registration pursuant to Section 12(g) of the Exchange Act if the issuer furnishes to the Commission information that the issuer has: Made or is required to make public pursuant to the law of the country in which the foreign private issuer is domiciled or incorporated; filed or is required to file with a stock exchange on which the securities are traded and which the exchange made public; or distributed or is required to distribute to its securityholders.[45]

The Commission has not included a specific proposal to change the Rule's requirements for Rule 12g3–2(b) issuers.[46] This is consistent with the general incorporation of Section 12 issuer information requirements and exemptions into the Rule. The Commission notes, however, that Rule 12g3–2(b) has no specific information requirements. As a result, there is no assurance that broker-dealers will have the same types of information for foreign private issuers that claim the Rule 12g3–2(b) exemption as broker-dealers will be required to have with respect to other issuers. In addition, many of the companies that claim the Rule 12g3–2(b) exemption are foreign microcap companies that can be subject to the same type of abusive practices as U.S. microcap companies.[47] Accordingly, the Commission is considering whether to limit a broker-dealer's reliance under Rule 15c2–11 on an issuer's 12g3–2(b) exempt status at least with respect to priced quotations.

Q28. Should the reference to Rule 12g3–2(b) be deleted from Rule 15c2–11? This would mean that broker-dealers publishing quotations for Rule 12g3–2(b) issuers' securities would be required to obtain and review the same information as required for all other foreign non-reporting issuers whose securities are subject to Rule 15c2–11. Comment is specifically requested with respect to Question 23 in the context of the requirements of Rule 15c2–11 as applied to Rule 12g3–2(b) issuers. Should a distinction in this respect be made depending upon whether the quotation is priced or unpriced?

Q29. Should reliance under Rule 15c2–11 on the Rule 12g3–2(b) exception not be permitted for those issuers whose principal market is the United States? If so, how should the principal market be determined? [48]

Q30. What difficulty, if any, would broker-dealers encounter in obtaining the information specified in proposed paragraph (d)(6) for a Rule 12g3–2(b) issuer?

Q31. Should the exception for Rule 12g3–2(b) issuers apply only to larger foreign private issuers, so that quotations for smaller issuers would require the information specified in proposed paragraph (d)(6)? If so, how should such distinction be measured? For example, if market value of public float is used, what would be the appropriate threshold (*e.g.*, $25 million, $75 million, $150 million, or some other amount)? If dollar value of average daily trading volume is used, what would be the appropriate threshold (*e.g.*, $100,000, $1 million, $5 million, or some other amount)?

Q32. Should the Rule 12g3–2(b) exception be available only for foreign private issuers that satisfy Nasdaq SmallCap quantitative listing standards (*i.e.*, at least $4 million in net tangible assets, or a market capitalization of at least $50 million, or net income in two of the last three fiscal years of at least $750,000, and a market value of public float of at least $5 million)?

Q33. Should there be a separate Commission rule requiring broker-dealers, whether or not they recommend a transaction in a security, to inform customers about available information regarding the issuer of the foreign security?

Q34. Should there be a separate Commission rule requiring broker-dealers, before recommending a transaction in a foreign security, to review financial information about the foreign issuer that is the basis of the recommendation and to document that review?

iv. Exempt financial institutions. Proposed paragraph (d)(4) would apply to financial institutions that are exempt from Exchange Act reporting requirements,[49] but file reports with other governmental agencies (''exempt financial institutions'').[50] The Commission has determined that,

[43] 17 CFR 240.15c2–11(a)(3).

[44] 17 CFR 240.12g3–2(b).

[45] The information may be submitted by a government official or agency of the country of the issuer's domicile or in which it is incorporated or organized.

[46] See proposed paragraph (d)(5) of the Rule. Broker-dealers publishing quotations for the securities of Rule 12g3–2(b) issuers would be subject to the updating requirements of proposed paragraph (b). Accordingly, broker-dealers would have to review updated information about these foreign private issuers following a Commission trading suspension or a five-day lapse in quotations. Broker-dealers also would have to review the issuer information on an annual basis in order to publish priced quotations. The Commission staff is considering whether Rule 12g3–2(b) continues to serve its original purpose and will evaluate whether changes to that rule should be proposed. If Rule 12g3–2(b) is amended, the interaction if that exemption with the requirements of Rule 15c2–11 could be affected.

[47] See *SEC* v. *Chelekis*, Litigation Release No. 15264 (February 25, 1997) (over half of the companies involved claimed the Rule 12g3–2(b) exemption).

[48] *See, e.g.*, definition of ''principal market'' contained in Rule 100 of Regulation M. 17 CFR 242.100.

[49] 15 U.S.C. 77(c)(a)(2), 78*l*(i).

[50] See *e.g.*, 12 CFR 363.4 (requiring insured banks to file annual reports with their respective bank supervisory agencies); 12 CFR 208.16 (requiring state member banks to file periodic reports with the Federal Reserve); 12 CFR 18.3 through .5 (requiring national banks to file annual disclosure statements with the Office of the Comptroller of the Currency (''OCC'')); FFIEC Forms 031–034 (requiring national banks to file annual call reports with the OCC and Federal Deposit Insurance Corporation); 12 CFR 562.2 (requiring federally chartered savings associations to file annual regulatory reports with the Office of Thrift Supervision (''OTS'')); NY Bank Section 37 and NY ADC § 24.1 (requiring all New York state chartered banks to file annual reports with the New York Banking Department); and Ca Fin Section 689 (requiring California state chartered banks to file annual reports with the California Department of Banking).

because the reports filed with federal or state bank supervisory agencies are readily available and contain information analogous to Exchange Act reports, broker-dealers should be required to obtain and review that information rather than the information required under proposed paragraph (d)(6) for other non-reporting issuers. Broker-dealers that quote the securities of financial institutions that file periodic reports with the Commission would have to obtain and review the information specified in proposed paragraph (c)(3) of the Rule.[51]

Q35. Should the Rule contain a separate provision relating to exempt financial institutions?

Q36. Would broker-dealers face any difficulties in obtaining information about exempt financial institutions that is filed with the appropriate regulatory authority?

v. Bankruptcy situations. *Issuers in Bankruptcy.* When the Commission issued a release in 1989 seeking comment on the piggyback provision (among other things), it inquired whether there were situations, such as issuer bankruptcies, that should be addressed if the piggyback provision were eliminated.[52] Many commenters on the 1989 Release argued that it was appropriate to permit broker-dealers to continue quoting the securities of issuers that had filed for bankruptcy because it provided liquidity for these securities. Commenters, including the NASD,[53] suggested that issuers in bankruptcy be designated as such in the quotation system by affixing a special indicator to the security's symbol. The NASD also recommended that this indicator be required on all confirmations of transactions involving the bankrupt issuer's securities and that broker-dealers publishing quotations for these securities be required to obtain, at a minimum, the most recent financial statements on file with the bankruptcy court.

The Commission disagreed with these views and stated that the initiation of any quotations, or indefinite continuation of priced quotations, for securities where the basic information required by the Rule is not available to the marketplace would undercut the prophylactic purposes of the Rule and might even encourage the abuses sought to be prevented.[54]

Commenters also suggested that broker-dealers could satisfy the Rule's requirements by reviewing court filings for an issuer in reorganization pursuant to Chapter 11 of the Bankruptcy Code.[55] However, these Chapter 11 filings generally are periodic reports that ordinarily contain only receipts and disbursements.[56] These periodic reports do not provide the type of issuer financial information contemplated by the Rule. In particular, where a bankrupt issuer meets the criteria for Exchange Act reporting, it would be inconsistent with the public interest and protection of investors to permit broker-dealers to facilitate trading by publishing quotations without reviewing Exchange Act information. Therefore, under the proposals, broker-dealers would not be able to initiate or resume quotations for the securities of issuers in bankruptcy and could not publish priced quotations for those securities as of the annual update requirement, unless they have obtained and reviewed the Rule's required information.

Q37. What difficulties does this position present for broker-dealers quoting securities of issuers that file for bankruptcy?

Issuers Emerging from Bankruptcy. The Commission recently received a petition for rulemaking seeking a revision of the financial statement requirements for non-reporting issuers emerging from bankruptcy.[57] In addition to the issuer's most recent financial statements, the Rule currently requires that a broker-dealer review similar financial information for the two preceding years. This requirement could result in a review of pre-bankruptcy financial information that has little bearing on the financial condition of the issuer emerging from a Chapter 11 reorganization. The Commission agrees with the suggestion made in the petition and proposes to amend Rule 15c2–11 to limit a broker-dealer's review to the court-approved disclosure statement[58] for the issuer's plan of reorganization and the issuer's financial information from the date the bankruptcy court confirms the reorganization plan.

Q38. Does the proposed amendment deal appropriately with issuers emerging from bankruptcy?

b. Supplemental Information. Rule 15c2–11(b)(2) currently requires a broker-dealer to maintain in its records a copy of any trading suspension order issued in the 12 months preceding the publication or submission of the quotation.[59] In addition, Rule 15c2–11(b)(3) requires a broker-dealer to preserve material information regarding the issuer which comes to the broker-dealer's attention before publishing the quotation or submitting the quotation for publication.[60] The Commission is proposing to retain these provisions. As under the current Rule, a broker-dealer would be required to consider this supplemental information, along with the issuer information, when it determines whether it has a reasonable basis for believing that both the issuer information and supplemental information are accurate, current, and from reliable sources.[61]

c. Significant Relationship Information. Currently, Rule 15c2–11 requires a broker-dealer to record information regarding the broker-dealer's relationship with those non-reporting issuers whose securities are being quoted. Specifically, broker-dealers must document whether:

- The broker-dealer or any associated person is affiliated with the issuer;
- The quotation is being entered on behalf of another broker-dealer and, if so, its name; and
- Whether the quote is being submitted on behalf of an insider or control person of the issuer, the name of the person, and the basis for any exemption from the federal securities laws for sales by such person.

The purpose of this information is to alert regulators and others of possible ''red flags,'' such as potential violations of the registration provisions of the Securities Act.

The proposed amendments would retain these requirements and apply

[51] Broker-dealers publishing quotes for securities of exempt financial institutions may obtain the regulatory reports from the financial institution by contracting their primary bank regulatory agency. Broker-dealers can access the Federal Reserve System's National Information Center of Banking Information website, www.ffiec.gov/NIC, the Federal Deposit Insurance Corporation's (''FDIC'') website, www.fdic.gov, which provides the most recent Call Reports for all FDIC insurance banks, or the OCC's website, www.occ.treas.gov, which has information about individual nationally chartered banks. Broker-dealers that access exempt financial institution information through these websites would be able to satisfy the Rule's requirements by recording their review and preserving the information in the same manner as for EDGAR information discussed above.

[52] Securities Exchange Act Release No. 27247 (September 14, 1989), 54 FR 39194 (''1989 Release'').

[53] See 1992 NASD Letter, *supra* note 37.

[54] 1991 Proposing Release, 56 FR at 19158.

[55] 11 U.S.C. 1101 *et seq.*

[56] See Federal Rule of Bankruptcy Procedure 2015.

[57] See Letter from Daniel J. Demers to Nancy J. Sanow, Assistant Director, Division of Market Regulation, SEC (November 14, 1997). This petition for rulemaking is available in File No. 4–405 in the Commission's Pubic Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549.

[58] 11 U.S.C. 1125. The disclosure statement includes, among other things, a description of the issuer's business plan, a description of any securities to be issued, and financial information.

[59] 17 CFR 240.15c2–11(b)(2). Information regarding recent trading suspension orders can be obtained by calling (800) SEC–0330.

[60] 17 CFR 240.15c2–11(b)(3).

[61] *Cf.* Robin Rushing, *supra* note 35.

them to all covered OTC securities, not just those of non-reporting issuers. In addition, the proposals would require the broker-dealer to record whether it had any arrangement to receive any compensation for publishing the quotation and, if so, a description of the compensation and the name of the person providing it.

Microcap fraud often involves payments by the issuer (or insiders or promoters of the issuer) or other broker-dealers to the broker-dealer to create a market in the issuer's stock.[62] The Commission believes that the records created by the broker-dealer under the proposals would help expose improper arrangements, which can mislead market participants as to the quality of a broker-dealer's quotations.[63] Moreover, this information also would assist regulators in identifying broker-dealers that may be acting as ''fronts'' for other broker-dealers or the issuer by publishing ostensibly independent quotes.

Q39. Is there a better way to identify when compensation has been paid to broker-dealers for publishing quotations?

5. Exceptions to the Rule

Under the proposed amendments, the current exceptions relating to quotations representing a customer's indication of interest and not involving the solicitation of a customer's interest, quotations for municipal securities, and quotations representing a security listed and traded on a national securities exchange or authorized for quotation on Nasdaq remain substantively the same.

Q40. Is there any reason to continue the requirement in the exception regarding exchange-listed securities that the security be traded on the exchange in proximity to the day the OTC quotation is published?

The Commission is concerned that the proposed changes may result in misuse of the exception covering unsolicited customer orders, particularly if a broker-dealer wants to publish quotations for a security but cannot obtain the requisite issuer information. The unsolicited status of the underlying customer orders would be called into question if a broker-dealer repeatedly publishes quotations on the basis of this exception.[64] In that circumstance, the broker-dealer's activities would suggest that it is acting as a market maker, rather than a broker or dealer attempting to fill unsolicited customer orders.

Q41. How frequently and under what circumstances do broker-dealers rely on the unsolicited customer order exception?

Q42. Is it appropriate for the Rule to retain an exception for unsolicited customer orders?

Q43. Should unsolicited customer orders be required to be identified as such in the quotation medium?[65]

Q44. Should there be a limited exception for a quotation reflecting isolated proprietary transactions by the broker-dealer? What should be the parameters of any such exception?

Debt Securities. Rule 15c2–11 covers debt securities, although the Commission recognizes that broker-dealers publishing quotations for debt securities may not have focused on this aspect of the Rule. Debt securities frequently are held by institutional investors, and it does not appear that they have been the subject of the abuses that the Rule is intended to address.

Q45. In light of these considerations, should the Rule continue to apply to debt securities? Should the Rule except all non-convertible debt securities or just non-convertible investment grade debt securities?

6. Information Available upon Request

Rule 15c2–11(a)(5) currently provides that the information described in that paragraph must be made available upon request to any person expressing an interest in a transaction in that security with the broker-dealer.[66] This requirement may have little practical effect because only the first broker-dealer to publish quotations must have the information, and an investor might find it difficult to identify that broker-dealer.[67] In fact, that broker-dealer may no longer be publishing quotations. The proposed amendments would require every broker-dealer that publishes quotations for covered OTC securities to obtain, review, and preserve the specified information. The Commission believes that some microcap fraud could be prevented if there were greater investor access to information about these securities and their issuers. Accordingly, the Commission is proposing to enhance the accessibility of this information by requiring a broker-dealer publishing quotations for any covered OTC security to make the information promptly available upon request by any person.

The Commission believes that the cost of requiring broker-dealers to make the information available (including to other broker-dealers) upon request is minimal. Also, the requirement to provide the requested information would prevent a broker-dealer from arranging with the issuer to have exclusive access to the issuer's information and thereby have sole access to Rule 15c2–11 information. This result would be anti-competitive and detrimental to the marketplace.

The proposed amendments would retain in substantial form the current clause that providing information to others does not constitute a representation by the broker-dealer that the information is accurate. Providing the information to others instead would constitute a representation that the information is current in relation to the date the information was reviewed, and that the broker-dealer has a reasonable basis for believing that the information is accurate and from reliable sources.

Q46. Under what circumstances do broker-dealers currently provide Rule 15c2–11 information to others?

Q47. Should the proposed rule specifically permit broker-dealers to charge a reasonable fee to offset their costs of providing the information?

Q48. Should the scope of this provision be limited to non-reporting issuers because information about reporting issuers is available to investors, such as on EDGAR through the Internet? If this requirement should be limited to non-reporting issuer information, should broker-dealers be required to furnish the supplemental and significant relationship information about reporting issuers?

7. Preservation of Documents and Information

To facilitate compliance with the Rule's recordkeeping requirements, the Commission believes that it is appropriate to codify the Rule's record preservation requirements in Rule 17a–4,[68] rather than in Rule 15c2–11.

Rule 17a–4 obligates broker-dealers to preserve documents and information that they must compile pursuant to Commission rules for the time period and in the manner specified in the

[62] See *Butcher & Singer, Inc.,* 48 S.E.C. 640 (1987); *Douglass and Co., Inc.,* 14 S.E.C. 537 (1978); *Gotham Securities Corporation,* 46 S.E.C. 723 (1976). See also NASD Rule 2460 (prohibiting broker-dealers from receiving payment from an issuer or a promoter for publishing a quotation or acting as a market marker).

[63] See *General Bond & Share Co.,* 51 S.E.C. at 413–414.

[64] *Cf. D.H. Blair & Co.,* 44 S.E.C. 320, (1970) (noting that insertion of both bid and ask quotations in the Pink Sheets for a customer is a highly unusual practice).

[65] Currently the exception for unsolicited customer orders is not available for customer orders representing both a bid and an offer at specified prices, unless the quotation medium identifies the quotations as customer orders.

[66] See 17 CFR 240.15c2–11(a)(5).

[67] As discussed above, this is a consequence of the current piggyback exception.

[68] 17 CFR 240.17a–4.

various provisions of Rule 17a–4. The Commission therefore is proposing to amend Rule 17a–4 to add the information specified in proposed paragraphs (d), (e), and (f) of Rule 15c2–11 to the other information that broker-dealers are already required to preserve under Rule 17a–4. Rule 15c2–11, as proposed to be amended, also would cross reference this proposed requirement.

With regard to issuer information that is accessible to broker-dealers through the Commission's EDGAR system, the proposed revisions would provide that if broker-dealers satisfied the Rule's requirements by obtaining and reviewing the information contained on EDGAR, they would not need to preserve such information independently, as long as they document the review and the information is accessible on EDGAR for the same period of time that the broker-dealers are obligated to preserve such information pursuant to Rule 17a–4. For example, if a broker-dealer is required by Rule 15c2–11 to obtain and review an issuer's Annual Report on Form 10–K and to preserve that information for three years, then as long as the broker-dealer can electronically access the Form 10–K for that three-year period, it does not have to preserve the document independently in a separate location. Broker-dealers still would need to preserve information about reporting issuers that is not available on EDGAR, *e.g.*, other information that comes to their attention before entering a quotation.

Q49. Are there other ways to ease the Rule's recordkeeping requirements for broker-dealers?

8. Information Provided to the NASD

Rule 15c2–11 currently requires any broker-dealer covered by the Rule to submit the information required under paragraph (a)(5) (*i.e.*, for non-reporting issuers) to the interdealer quotation system, in the form prescribed by the system, at least three business days before submitting a quotation for publication. The Commission is proposing to amend this obligation by requiring broker-dealers to submit the information that they must obtain and review pursuant to Rule 15c2–11 to the NASD only, in accordance with the NASD's rules. Previously, this information was not obtained by an SRO (a substantial proportion of the documents were submitted to the National Quotation Bureau, Inc., the publisher of the Pink Sheets). Presently, NASD Marketplace Rule 6740 requires broker-dealers to submit the Rule 15c2–11 information to the NASD before they can publish a quotation for a covered OTC equity security in any quotation medium. The proposed amendment would recognize broker-dealers' obligation under NASD rules and avoid any possible need to make multiple submissions of the same information (*e.g.*, to the NASD and to one or more interdealer quotation systems). The NASD uses this information for surveillance and enforcement purposes and routinely provides copies of this information to the Commission.

Q50. Does there continue to be any need for the Rule to require that the information be supplied to the operator of each interdealer quotation system?

B. Central Information Repository

The elimination of the piggyback provision and the increased costs of compliance that may result suggest the desirability of having a central data base of information, particularly for the securities of non-reporting issuers. Such a data base also would enhance the availability of information about little known issuers to investors, other professionals, and regulators. For these reasons, the Commission encourages the development of one or more repositories for Rule 15c2–11 information.

In the 1991 Proposing Release, the Commission contemplated that a Rule 15c2–11 repository would:

(1) collect information about a substantial segment of issuers of securities subject to the Rule;

(2) maintain current and accurate information about such issuers;

(3) use effective acquisition, retrieval, and dissemination systems;

(4) charge reasonable fees; and

(5) operate in a manner that would permit it reasonably to carry out the purposes of the Rule.[69] The Commission seeks comments concerning the features and the feasibility of a central information repository.

Q51. Should the Rule incorporate the standards above? Are there other standards that should be included?[70]

Q52. Should the Commission promote the development of central information repositories through other means?

C. Definitions

The proposals would revise or eliminate several definitions now contained in Rule 15c2–11 and add a few new definitions. The current definitions of ''issuer'' and ''quotation'' would be retained.

Q53. Are the proposed definitions appropriate in light of the Rule's purposes?

Quotation Medium. The definition of ''interdealer quotation system'' would be incorporated into the definition of ''quotation medium.''[71] This definition is quite inclusive: it covers any publication or electronic communications network, or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell. The Commission has been advised by the NASD that almost all Forms 211 that it receives are filed for quotations to be published in the OTC Bulletin Board or the Pink Sheets. Transaction data indicates, however, that there is significant trading in OTC securities that are not quoted in these quotation mediums. While there can be many explanations for this phenomenon, it is possible that broker-dealers view Rule 15c2–11 as applying only to quotations published in the Bulletin Board or the Pink Sheets. In fact, the Rule applies to quotations published in any quotation medium.

Q54. What is the experience of broker-dealers under the Rule when publishing quotations in quotation mediums other than the Bulletin Board or the Pink Sheets?

Q55. Is the scope of the definition of quotation medium too broad?

Q56. Should the Rule except mediums that do not identify broker-dealers publishing quotations (*i.e.*, where quotations are anonymous) and/or that do not provide automatic execution facilities? Why would this be appropriate or inappropriate?

Q57. Should the definition draw any distinction between ''quotations'' and ''orders''?

Q58. Should the Rule apply to quotation systems devoted exclusively to a single issuer's securities? If so, would an aggregation of such systems be a quotation medium?

Q59. Should the Rule apply to quotation systems devoted exclusively to a single broker-dealer's quotations? If so, would an aggregation of such systems be a quotation medium?

Q60. Should the definition of ''interdealer quotation system'' be retained?

[69] 56 FR at 19163.

[70] Commenters may also wish to consider the need for a process to recognize repositories that meet such standards. *Cf.* Securities Exchange Act Release No. 39457 (December 17, 1997), 62 FR 68018 (proposing the process for designating ''nationally recognized statistical rating organizations'' for purposes of the New Capital Rule, 17 CFR 240.15c3–1).

[71] A separate definition of ''interdealer quotation system'' no longer would be necessary because of the elimination of the piggyback provision and the revision that the information be furnished to the NASD in accordance with NASD rules, rather than to interdealer quotation systems.

D. Transition Provision

The Commission is proposing a transition provision covering quotations by broker-dealers that were initiated prior to the effective date of the proposed amendments. Broker-dealers could continue their market-making activities until the occurrence of one of the events set forth in the Rule, as proposed to be amended. The Commission believes that this proposed transition provision would be necessary to maintain liquidity in covered OTC securities while broker-dealers adjust to the amended requirements. Broker-dealers initiating quotations for these securities, however, would need to obtain and review the requisite information.

Q61. Does the proposed transition provision adequately address securities that broker-dealers may have been quoting for significant periods of time, and for which they may be unable to obtain current information from the issuer?

Q62. Under what circumstances should the Rule accommodate those broker-dealers that would like to initiate quotations for securities covered by the transition paragraph but for which they cannot obtain the requisite issuer information?

III. General Request for Comments

The Commission solicits comment on all aspects of its proposed amendments to Rule 15c2–11, as well as on any other matter that might have an impact on the proposals discussed above. In particular, the Commission seeks comment on whether the proposals would help promote information transparency in the OTC market and help curb abuses in the trading of microcap securities. Commenters are asked to consider whether the proposed revisions would have any adverse impact on the liquidity of covered OTC securities and should provide data and analysis to support their views. Commenters are invited to address whether the Rule's text is sufficiently clear and understandable. In addition, commenters are asked to discuss whether the Rule and/or proposed amendments should apply to quotations for all securities covered by Rule 15c2–11, or whether certain amendments (*e.g.*, disciplinary histories of an issuer's insiders and promoters) should be limited to quotations for microcap securities.

Persons submitting written comments should send three copies of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, and should refer to File No. S7–3–98. Comments also may be sent electronically to the following e-mail address: rule-comments@sec.gov and should include the file number on the subject line of the e-mail.

IV. Costs and Benefits of the Proposed Amendments

The Commission requests commenters to evaluate the costs and benefits associated with the proposed amendments to Rule 15c2–11. The Commission has identified certain costs and benefits relating to the proposals, which are discussed below, and encourages commenters to discuss any additional costs or benefits.[72] In particular, the Commission requests comment on the potential costs for any necessary modifications to information gathering, management, and recordkeeping systems or procedures that would be necessary to implement the proposals, as well as any potential benefits resulting from the proposals for issuers, investors, broker-dealers, securities industry professionals, regulators or others. Commenters should provide analysis and data to support their views on the costs and benefits associated with the proposals.

A. Benefits

The Commission believes that the proposed amendments generally would help improve the quality of the markets for securities subject to Rule 15c2–11 and would help protect investors from fraudulent schemes involving these securities. Traders of the securities of legitimate microcap issuers also would benefit if the integrity of this market sector is improved. The Commission believes that the specific benefits set forth below would flow from the proposed amendments.

The Commission does not routinely collect, as part of its examinations or investigations, data for the dollar value of fraudulent activity and therefore cannot quantify investor losses due to recent microcap frauds. However, from its enforcement investigations and interactions with other regulators, and review of investor complaints, the Commission believes microcap trading abuses are on the rise and overall involve significant dollar amounts.

Microcap fraud frequently involves issuers for which public information is limited.[73] Without information, it is difficult for investors, securities professionals, and others to evaluate the risks presented by these securities. Many investors consequently fall prey to persons who make false representations and unrealistic predictions about these securities. The publication of quotations by broker-dealers can facilitate the fraudulent promotion of microcap securities. Currently, not all broker-dealers are required to review certain basic information about an issuer before initiating quotations.

To reduce the potential for fraud in the OTC market, the proposed amendments require every broker-dealer, before initiating a quotation for a covered OTC security in a quotation medium, to gather and review the issuer information and to update that information annually when it publishes priced quotations. The proposed amendments would require more information than the Rule currently requires about the issuer's outstanding securities, its officers and directors, and its financial condition. In particular, by requiring that all broker-dealers obtain and review issuer information and update it annually, the proposed amendments should substantially assist a broker-dealer in its consideration of whether to publish quotations for an issuer's securities. Provided with this additional information, the broker-dealer would gain a greater understanding of the issuer's business and a better indication of whether potential or actual fraud or manipulation may be present.

After reviewing the information, responsible broker-dealers should refrain from publishing quotations for questionable securities. This will prevent responsible broker-dealers from becoming unwitting participants in manipulative or fraudulent schemes of unscrupulous broker-dealers and/or promoters. Because all broker-dealers must have issuer information before initiating quotations for covered OTC securities, issuer information would be more widely available to market professionals. Additionally, broker-dealers must provide this information to any person upon request.

The proposals, if adopted, would serve an important surveillance function. Currently, only the first broker-dealer quoting a security must gather, review, and preserve the information. The proposed amendments would require all broker-dealers

[72] In 1985, the Commission issued a release for the purpose of seeking comment on the costs and benefits associated with Rule 15c2–11. Securities Exchange Act Release No. 21914 (April 1, 1985), 50 FR 14111. The comment letters are available in File No. S7–14–85. Generally, the commenters failed to provide data to support costs or benefits.

[73] See, *e.g.*, *SEC* v. *Global Financial Traders, Ltd.*, Litigation Release Nos. 15291 (March 14, 1997), and 15338 (April 17, 1997); see also *supra* note 10.

initiating quotations to satisfy the Rule's current requirements and would add a recordation requirement. Moreover, under NASD Marketplace Rule 6740, the broker-dealer demonstrates its compliance with that rule by filing the Rule 15c2–11 information with the NASD. Recently, the review of Forms 211 filed with the NASD has resulted in a number of Commission trading suspensions and other enforcement actions.

The proposed amendments would ease significantly the Rule's recordkeeping requirement when broker-dealers have access to reporting issuer information on the Commission's EDGAR system. Access to EDGAR is free on the Internet. Given that approximately 42% of securities on the OTC Bulletin Board (''OTCBB'') and Pink Sheets are issued by reporting companies, whose reports are included on EDGAR, a significant recordkeeping cost savings to broker-dealers should result.

The Commission does not have data to quantify the value of the benefits described above. The Commission seeks comments on the value of these benefits and on any benefits, not already identified, that may result from the adoption of these proposed amendments.

B. Costs

The Commission has identified various costs that may result if the proposals are adopted. The proposals would eliminate the piggyback provision, which now effectively limits the Rule's application to those broker-dealers that publish quotations during the first 30 days of the security's trading. Under the proposals, each broker-dealer would need to obtain and review the Rule's required information when it initiates quotations for the security or initiates or resumes quotations following specified events. Moreover, an annual update requirement would apply to all broker-dealers that publish priced quotations. As a result of these proposals, each broker-dealer publishing quotations for a security would have to obtain issuer information and possibly incur costs when it first publishes a quotation and when it conducts the required update. To the extent a broker-dealer does not already have this information, it would incur costs for the collection and review of this information. Moreover, a broker-dealer also would incur costs associated with creating the records required by the Rule and retaining the Rule's required information for the specified period of time pursuant to the proposed amendment to Rule 17a–4.

The Commission estimates that it would cost a broker-dealer $35 per hour to comply with the requirements of the Rule based on a blended compensation rate of $35 per hour for clerical and supervisory compliance staff. As identified in the Paperwork Reduction Act section of this release, the Commission estimates that the additional annual burden hours to broker-dealers in the aggregate would be approximately 127,000 hours. The Commission, therefore, estimates that the cost to broker-dealers in the aggregate to obtain and review the required information if the proposed amendments are adopted would be approximately $4,445,000. The Commission seeks comments on the reasonableness of its estimates for the additional annual hourly and dollar costs to broker-dealers.

The Commission believes that any additional costs to broker-dealers should be offset, however, by the fact that those broker-dealers conducting a retail business already may have the information required to satisfy their obligations under the federal securities laws and the rules of the SROs when they recommend a security to an investor.

Although Rule 15c2–11 does not regulate issuers, there may be some indirect costs imposed on issuers, particularly non-reporting issuers, because they may be contacted by broker-dealers to provide the information specified in the Rule. Non-reporting issuers would incur the cost of having to collect and provide the requested information to each requesting broker-dealer. In addition, the proposals would expand the scope of the information required for quotations of non-reporting issuers' securities. However, the Commission is assuming that non-reporting issuers maintain their financial information in compliance with prevailing accounting standards and, in most instances, would have available updated financial information prepared in accordance with GAAP. The NASD has informed us that the financial statements filed with the Form 211 generally are prepared in accordance with GAAP, and many are audited.

The Commission assumes that for non-reporting issuers, it will cost approximately $15 per hour for clerical staff to obtain and provide the information required if the proposed amendments are adopted.[74] As identified in the PRA section of this release, the Commission estimates that the additional annual reporting burden hours to non-reporting issuers in the aggregate would be approximately 50,000 hours, or approximately $750,000 per year. The Commission seeks comments on the reasonableness of its estimates for the additional annual hourly and dollar costs to issuers.

Regarding start-up, operating, and maintenance costs, the Commission believes that broker-dealers that now collect, review, and retain the information required by the current Rule would incur only marginal start-up, operating, and maintenance costs (*i.e.*, to expand systems already in place). Further, some broker-dealers may be collecting the information required by the proposals for other purposes. However, the Commission believes some broker-dealers may not have adequate systems in place to retain issuer information and would, therefore, incur start-up, operating, and maintenance costs in order to comply with the requirements of the proposed amendments.

As discussed in the PRA section of this release, the Commission estimates that an average of 4.3 broker-dealers provide quotations for each of the 7,038 covered OTC securities that would be affected if the proposed amendments are adopted. The Commission estimates that broker-dealers would incur start-up, operating, and maintenance costs of approximately $17,736 associated with reporting issuer information, and approximately $97,968 associated with non-reporting issuer information. The total start-up, operating and maintenance cost burden for broker-dealers is estimated to be $115,704 ($17,736+$97,968). The Commission seeks comments on the reasonableness of its estimates for the total start-up, operating and maintenance cost burdens to broker-dealers.

Finally, the Rule could affect the liquidity of some securities. If broker-dealers are unable to obtain the required issuer information, they would have to refrain from publishing priced quotations in that security. This could make it more difficult for investors to determine what prices other market participants are willing to bid or offer for the security. However, broker-dealers may still publish unpriced quotes and publish priced quotes representing unsolicited customer interest in buying or selling securities. It should also be possible for some broker-dealers to continue to make

[74] The Commission assumes that because the required information should be available in house, someone in a clerical position should be able to copy and forward the information in response to a request. Accordingly, the Commission believes that $15 per hour is a reasonable estimate of this cost.

markets without publishing quotations in a quotation medium. Thus, while investors are still able to obtain price information, the cost of obtaining this information may increase. Any effect on liquidity must be weighed against the benefit of stopping potential fraud or manipulation. Greater investor access to information should result in more informed investor decisions and potentially could result in additional trading and thus liquidity for covered OTC securities. The Commission's preliminary view is that the benefits of the proposed rule changes should justify any adverse impact on liquidity.

The Commission seeks comments on the cost estimates identified in this section and comments on any cost, not already identified, should the amendments be adopted as proposed. Commenters are requested to supply specific data and analysis.

V. Effects on Efficiency, Competition, and Capital Formation

In adopting rules under the Exchange Act, Section 23(a)(2) requires the Commission to consider the impact any rule would have on competition and to not adopt any rule that would impose a burden on competition not necessary or appropriate in the public interest. Section 3(f) of the Exchange Act requires the Commission, when engaged in rulemaking, to consider or determine whether an action is necessary or appropriate in the public interest, and whether the action would promote efficiency, competition, and capital formation.[75] The proposed amendments are intended to protect investors by requiring broker-dealers that initiate or resume quotations for a covered OTC security in a quotation medium, and that are publishing priced quotations as of the annual update requirement, to have fundamental information about the issuer.

When reports of fraud and manipulation in a particular market sector are common, legitimate participants in that marketplace are adversely affected. For example, legitimate small issuers seeking capital in the public markets may find that their costs of raising capital are increased because of underwriters' and, ultimately, investors' reluctance to participate in these transactions. Measures to reduce microcap fraud should result in enhanced capital formation by legitimate small issuers.

The Commission believes that the requirement to obtain and review issuer information should improve the level of competition among broker-dealers because all broker-dealers would be affected equally. With the elimination of the piggyback provision, every broker-dealer must obtain and review the information in connection with a decision to publish quotations. Absent these requirements, the Commission believes that some broker-dealers would submit quotations without regard to basic information about relatively unknown issuers, and therefore, would be more likely to cause investors to fall prey to fraudulent and manipulative pricing schemes. Because all broker-dealers would now be subjected to the same requirements to gather and review the information before publishing quotations, fairness and competition in this segment of the industry should improve.

The Commission's preliminary view is that the proposed amendments to the Rule would not have any anticompetitive effects that are not necessary or appropriate in the public interest. There may be isolated cases where some broker-dealers can continue to publish unpriced quotations for a security because issuer information was available when they initiated quotations or the security qualifies for the transition provision covering quotations occurring prior to the amendment's effective date, yet other broker-dealers later cannot initiate or resume quotations because current issuer information is no longer available. Because of the proposed annual updating requirement, the broker-dealer would only be able to publish unpriced quotations after the updating period (if current issuer information was not available). Although in such cases some broker-dealers may be precluded from publishing quotations in a quotation medium, the Commission preliminarily considers this possible burden on competition to be justified by the benefits to investors of broker-dealers having accurate and current issuer information before they initiate or resume publication of quotations in a quotation medium.

The Commission requests comments on the competitive benefits that may result to broker-dealers under the proposed amendments to the Rule and also is requesting comments on any anticompetitive effects that may result if the Rule is adopted as proposed. The Commission is aware that requiring broker-dealers to collect information more regularly may cause some broker-dealers to stop publishing quotations, thus reducing the liquidity of some securities. The Commission requests data and analysis on what effect the proposed changes may have on the liquidity of this market. Finally, the Commission seeks comment on what impact the proposals, if adopted, would have on efficiency and capital formation.

VI. Initial Regulatory Flexibility Act

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA'')[76] regarding the proposed amendments to Rule 15c2–11 and the companion amendment to Rule 17a–4 under the Exchange Act. The following summarizes the IRFA.

As discussed in the IRFA, the Rule specifies the information that a broker-dealer must gather and review before publishing quotations for covered OTC securities. The Rule is intended to prevent broker-dealers from publishing quotations for covered OTC securities in a quotation medium without obtaining, reviewing, and retaining current information about the issuer. The Commission is proposing these amendments because of increased incidence of fraud and manipulation in securities subject to Rule.

The amendments to the Rule would affect all broker-dealers, including a number of small broker-dealers, seeking to publish quotations for covered OTC securities. The Commission's Office of Economic Analysis (''OEA'') estimated that as of December 31, 1996, there were 3,444 small public broker-dealers. Based on Exchange Act Rule 0–10(c)(1), OEA considered a small broker-dealer as a broker-dealer reporting total capital of less than $500,000 at year-end 1996. The number of these small broker-dealers that submit quotations for covered OTC securities to quotation mediums is unknown. However, the Commission believes that, at any given time, there are approximately 400 broker-dealers, including small broker-dealers, that submit quotations for covered OTC securities. The Commission seeks comments on the number of small broker-dealers that quote covered OTC securities in quotation mediums.

The proposed amendments would indirectly affect those small issuers that may be requested to provide the information required by the proposed amendments to broker-dealers publishing quotations in those issuers' securities. Based on Exchange Act Rule 0–10(a), a small issuer is one that on the last day of its most recent fiscal year had total assets of $5,000,000 or less. The total number of small issuers of covered OTC securities is not known at this time. The Commission seeks comment on the total number of issuers of covered OTC securities; the number (or

[75] 15 U.S.C. 78c(f).

[76] 5 U.S.C. 603.

percentage) of these issuers that are small issuers; and the total number (or percentage) of small issuers of covered OTC securities that are reporting and non-reporting issuers, respectively.

As discussed above in this release, the proposed amendments would eliminate the piggyback provision and would specify that every broker-dealer must gather and review the required information when it initiates or resumes publishing quotations for a covered OTC security. At least once a year thereafter in the case of priced quotations, or following a break in quotations of five or more business days or upon the termination of a Commission trading suspension order, a broker-dealer would have to gather and review the information required by the Rule.

In addition, a broker-dealer would be required to maintain information concerning its compliance with the Rule, including whether: the broker-dealer is affiliated with the issuer; a quotation is being submitted on behalf of another broker-dealer or associated person (including the name of such broker-dealer); the quotation is being submitted on behalf of the issuer or persons affiliated with the issuer; and the broker-dealer has received any monetary or other compensation to publish the quotation.

The Commission is also proposing to require broker-dealers to acquire and review the annual and other periodic reports that financial institutions file with their respective regulatory agencies other than the Commission. The Commission believes that because non-reporting financial institutions file periodic reports containing information similar or identical to information that reporting financial institutions file with the Commission, a broker-dealer quoting such financial institutions' securities should obtain these reports in order to achieve the informational goals of the Rule.

The possible addition of recordkeeping costs for broker-dealers as a result of eliminating the piggyback provision and enhancing the required issuer information further highlights the desirability of creating a central data base for information on covered issuers and their securities. In that regard, the Commission encourages the development in the private sector of one or more central repositories for Rule 15c2–11 information. Such repositories may provide a more efficient vehicle for meeting the record-assembly needs of brokers and dealers, including firms seeking to comply not only with the Rule, but also with other applicable investor protection requirements, such as general anti-fraud and suitability rules of the Commission and SROs.

The IRFA notes that the availability of the Commission's EDGAR system for broker-dealers to collect and review the reports required by the Rule should lessen the costs and burdens associated with compliance with any expanded information gathering, review, and updating requirements. In addition, the prevalent use of computers and the Internet, on which access to EDGAR is free, should also reduce the recordkeeping and compliance costs for all broker-dealers by automating the information collection and retention process.

The IRFA recognizes that the proposed amendments indirectly affect certain issuers, particularly non-reporting issuers. The proposed amendments would require all broker-dealers, before initiating or resuming publication of a quotation, to obtain, review, and retain more issuer information than is currently required under Rule 15c2–11 and, when publishing priced quotations, to update that information annually. Consequently, non-reporting issuers must collect and provide the required information for each requesting broker-dealer. The Commission assumes that non-reporting issuers maintain their financial information in compliance with prevailing accounting standards and that the cost incurred by non-reporting issuers to prepare the necessary information in response to broker-dealers' requests would be minimal.

The IRFA discusses the kinds of possible alternative proposals that the Commission has considered. These include, among others, creating differing compliance or reporting requirements or timetables that take into account the resources available to small entities, and whether such entities could be exempted from any of the proposed rules, or any part thereof. Therefore, having considered the foregoing alternatives in the context of the proposed amendments, the Commission does not believe they would accomplish the stated objectives of the proposal.

The Commission encourages the submission of written comments regarding any aspect of the IRFA. In particular, the Commission seeks comments on: (i) The number of small entities that would be affected by the amended Rule, including the number of small broker-dealers and issuers; (ii) the number of small entities that are issuers of covered OTC securities; and (iii) the number of small entities that are reporting and non-reporting issuers of covered OTC securities, respectively. Comments should also specify the costs of compliance with the proposed amendments, and suggest alternatives that would provide the OTC market with more information about the issuers of these securities. In describing the nature of any impact that the proposals would have, empirical data supporting these views should be provided.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is also requesting information regarding the potential impact of the proposed amendments on the economy on an annual basis. In particular, comments should address whether the proposed changes, if adopted, would have a $100,000,000 annual effect on the economy, cause a major increase in costs or prices, or have a significant adverse effect on competition, investment, or innovations. Commenters should provide empirical data to support their views.

Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–3–98; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters will also be posted on the Commission's Internet web site (httpp://www.sec.gov).

A copy of the Initial Regulatory Flexibility Analysis may be obtained by contacting Chester A. McPherson, Office of Risk Management and Control, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at (202) 942–0772.

VII. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA''); [77] the Commission has submitted them to the Office of Management and Budget for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is: ''Publication or submission of quotations without specified information.'' This collection of

[77] 44 U.S.C. 3501 *et seq.*

information has previously been assigned OMB Control No. 3235–0202.

A. Collection of Information Under the Proposed Amendments

Rule 15c2–11 under the Exchange Act currently requires the very first broker-dealer publishing a quotation for certain over-the-counter (''OTC'') securities in a quotation medium to obtain and review the information specified in the Rule. Generally, the Rule applies to securities that are not listed and traded on a national securities exchange or quoted on Nasdaq (''covered OTC securities''). Most covered OTC securities are quoted in the OTC Bulletin Board (''OTCBB''), which is operated by the National Association of Securities Dealers, Inc. (''NASD''), or in the Pink Sheets (containing quotations for equity securities) or Yellow Sheets (containing quotations for debt securities), which are published by the National Quotation Bureau, Inc. (''NQB'').

The proposed amendments to Rule 15c2–11 would require every broker-dealer to collect, review, and retain specific information about the security's issuer before initiating or resuming a quotation for a covered OTC security. Broker-dealers submitting priced quotations for the security would be required to collect, review, and retain the Rule's specified information annually. Broker-dealers would also have to record the sources of their information, the date their review occurred, and the person responsible for the review. Also, the proposals would require broker-dealers publishing quotations for a covered OTC security to collect, review, and retain more information than is required currently.

Under Rule 15c2–11, the information that is collected pursuant to the Rule must be submitted to the NASD at least three business days before any quotation is published.[78] Finally, the proposed amendments would require broker-dealers to provide the information specified to any member of the public that requests it.

B. Proposed Use of Information

Broker-dealers must collect and review the information required under the proposed amendments before publishing a quotation. Moreover, the Rule requires that broker-dealers have a reasonable basis for believing that the information about the issuer and related persons is current, accurate, and from reliable sources. This information collection protects investors by deterring fraudulent or manipulative quotations for thinly-traded securities whose issuers are relatively unknown. Because information about these issuers is not widely disseminated and often is not current, fraudulent and manipulative schemes are easier to perpetrate. Moreover, this collection of information helps broker-dealers guard against becoming unwitting participants in fraudulent or manipulative schemes. The Rule 15c2–11 information gathering requirements also serve an important surveillance function for both the Commission and the NASD. Recently, the Commission has used the Rule 15c2–11 information to suspend trading in the issuers' securities pursuant to Section 12(k) of the Exchange Act where publicly available information about the issuer raised questions about the accuracy and adequacy of the issuers' disclosures.

C. Respondents

The proposed amendments would apply to those broker-dealers that initiate or resume publishing quotations for a covered OTC security in a quotation medium and that are publishing priced quotations as of the annual update requirement. The proposed amendments also indirectly affect issuers that are asked by broker-dealers to provide this information. Most of the Rule 15c2–11 information that would be required for issuers that publicly file periodic reports with the Commission (''reporting issuers'') is available electronically on EDGAR or through the Internet. Thus, the proposals are likely to have a greater paperwork burden when broker-dealers publish quotations for the securities of issuers that do not participate in the Commission's public reporting program (''non-reporting issuers'').

D. Total Annual Reporting and Recordkeeping Burden

The proposed amendments would require broker-dealers to collect, review, retain, and record certain issuer and supplemental information when they initiate or resume publishing quotations of the issuer's securities or continue to publish priced quotations as of the annual anniversary date. The proposed amendments contain an initial information gathering and review requirement for broker-dealers and, in the case of priced quotations, a subsequent annual updating requirement. The discussion below estimates the collection of information burden one year after the anticipated date of effectiveness of the proposed amendments when broker-dealers that publish quotes for covered OTC securities qualifying for the proposed transition provision must fully comply with the Rule's information requirements. The discussion below also provides estimates for the same period for issuers that may be contacted to provide the information. In particular, the following analysis measures the cost to broker-dealers of: (1) collecting, reviewing, recording, and retaining the required issuer information and supplying it to the NASD; (2) responding to requests for issuer information from the public; and (3) starting-up or maintaining systems for the collection and retention of issuer information. The analysis below also addresses the indirect cost to issuers who must furnish information to requesting broker-dealers.

1. Burden-Hours for Broker-Dealers

In 1997, the NASD reports receiving 1,576 applications from broker-dealers to initiate or resume publication of quotations for covered equity securities in the OTCBB and/or the Pink Sheets, and 1,107 of these applications were cleared for publication of quotations. Although there are other OTC quotation mediums, the NASD reports that it generally does not receive any submissions from broker-dealers publishing quotations in these other systems. Data about quotations for covered OTC securities in these other systems is unavailable.

Also, taking into account newly-published quotations in the Yellow Sheets, the Commission estimates that approximately 1,200 new covered OTC securities would be eligible for quotations in the year following the Rule's effective date. Based on information provided by the NASD and NQB, the Commission estimates that as of December 31, 1997, there were approximately 6,200 covered OTC securities quoted in the OTCBB; 3,000 quoted in the Pink Sheets; and 2,000 quoted in the Yellow Sheets for a total of 11,200 covered OTC securities quoted in all three mediums.

According to NASD and NQB estimates, the Commission believes that, on average, there are approximately 4.3 broker-dealers publishing quotations for each of these covered OTC securities, and that at any given time there are no more than 400 broker-dealers that submit quotations for covered OTC securities. Further, according to these estimates, priced quotations are published for approximately 89 percent of the 6,200 (5,518) OTCBB securities, 10 percent of the 3,000 (300) Pink Sheets securities, and 1 percent of the

[78] The NASD has a rule requiring broker-dealers that initiate or resume quotations for covered equity securities to submit verification that they have collected the information necessary to comply with NASD requirements, as well as Rule 15c2–11. See NASD Manual, Marketplace Rules, 6740.

2,000 (20) Yellow Sheets for a total of 5,838 issues with priced quotations. Because the proposed amendments would not require broker-dealers to collect issuer information for priced quotations until the annual update requirement is triggered in the year after the date of the amendments' effectiveness, the Commission estimates that, as of the annual update, approximately 30,263 ((5,838+1,200)×4.3) quotations would be subject to the Rule 15c2–11 proposed amendments.

For purposes of developing a burden estimate, the Commission assumes that each of the 5,838 priced quotations and the 1,200 new applications represent a different issuer. The Commission, therefore, estimates, at most, 7,038 issuers of covered OTC securities will be affected by the proposals in the year following the effective date of the amendments.[79]

Based on information from the NASD and NQB, the Commission estimates that of the 7,038 affected issuers of covered OTC securities, 42 percent (2,956) are reporting issuers, and 58 percent (4,082) are non-reporting issuers. The Commission estimates that it will take a broker-dealer about three hours to collect, review, record, retain, and supply to the NASD the information pertaining to a reporting issuer, and five hours to collect, review, record, retain, and supply to the NASD the information pertaining to a non-reporting issuer. The Commission estimates that broker-dealers will annually require 38,132 (2,956×3×4.3) hours or 95.33 (38,132/400) hours per broker-dealer to collect, review, record, retain, and supply to the NASD the information for the 2,956 affected reporting issuers. The Commission estimates that broker-dealers will annually require 87,763 (4,082×5×4.3) hours or 219.41 (87,763/400) hours per broker-dealer to collect, review, record, retain, and supply to the NASD the information from the 4,082 affected non-reporting issuers. Additionally, the broker-dealers, upon request from the public, must provide the issuer information. Based on information from the NQB, the Commission estimates that broker-dealers will receive 1,000 requests from the public annually, which would take a broker-dealer approximately one-half hour per request to provide for an annual burden of 500 hours. Therefore, the Commission estimates the total annual burden hours to broker-dealers to be 126,395 (38,132+87,763+500), or an average of 316 (126,395/400) burden hours per broker-dealer.

2. Burden-Hours for Issuers

Regarding the burden on issuers to provide broker-dealers with the required information, the Commission estimates that the 2,956 affected reporting issuers of covered OTC securities will not bear any additional hourly burdens under the proposed amendments because such issuers already report the required information to the Commission through periodic filings made pursuant to the federal securities laws. Further, reporting issuer information is widely available to broker-dealers through a variety of media. However, non-reporting issuer information is not widely available, and consequently, these issuers must provide the information required by the proposed amendments to requesting broker-dealers before quotations in their securities can be published. The Commission estimates that the 4,082 affected non-reporting issuers of covered OTC securities will spend an average of nine hours each to collect, prepare, and supply the information required by the proposals to the first broker-dealer that requests this information. Thereafter, the Commission estimates that it will take an average of one hour for an issuer to provide the same information to the remaining 3.3 broker-dealers that request the information. Accordingly, the Commission estimates the 4,082 non-reporting issuers annually will incur 36,738 (4,082×9×1) hours to comply with the first broker-dealer's request for information, and 13,471 (4,082×1×3.3) hours to comply with the subsequent 3.3 broker-dealer requests for an annual total of 50,209 (36,738+13,471) burden hours. On average, therefore, each non-reporting issuer would spend approximately 12 (50,209/4,082) burden hours per year to comply with these requests.

3. Total Burden-Hour Costs to Broker-Dealers and Issuers

For both broker-dealers and issuers combined and in the aggregate, the Commission estimates the collection of information will require approximately 176,604 burden hours annually (126,395+50,209).

4. Capital Cost to Broker-Dealers and Issuers

The Commission believes that broker-dealers that now collect, review, and retain the information required by the current Rule will not incur any significant start-up costs to expand systems already in place. Further, broker-dealers that are collecting the information required by the proposals for other purposes also will not incur significant start-up costs. However, the Commission believes some broker-dealers may not have adequate systems in place to retain issuer information and will incur start-up costs in order to comply with the requirements of the proposed amendments. The Commission assumes that of the 4.3 broker-dealers that provide quotations for each covered OTC security, on average one broker-dealer will incur additional start-up costs, while the remaining 3.3 broker-dealers will only incur incremental costs. Because the information for reporting issuers will be generally available on EDGAR and such availability satisfies the recordkeeping requirements of the proposals, the Commission is assuming that the start-up costs associated with retaining information on reporting issuers will be $6.00 per quotation, whereas the same costs will be $24.00 per quotation for non-reporting issuer information. The Commission estimates that broker-dealers in the aggregate will incur start-up costs of $17,736 (2,956×$6×1) associated with reporting issuer information, and $97,968 (4,082×$24×1) associated with non-reporting issuer information. The total start-up, operating and maintenance cost burden for broker-dealers is estimated to be $115,704 ($17,736+$97,968) or an average of $289 ($115,704/400) per broker-dealer.

The Commission assumes that non-reporting issuers, because they maintain their financial information in compliance with prevailing accounting standards, will not incur any start-up costs to prepare the required information in response to broker-dealers' requests. The Commission also believes that reporting issuers of covered OTC securities will not incur start-up costs as a result of the proposed amendments since such issuers already provide the required information to the Commission under the federal securities laws.

Therefore, the Commission believes issuers will not incur start-up costs as a consequence of the adoption of the Rule amendments, as proposed.

E. General Information About the Collection of Information

The collection of information under the proposed amendments is mandatory and would be required before broker-dealers could initiate or resume publication of quotations in securities that are traded in a quotation medium other than an exchange or Nasdaq and before broker-dealers could continue to

[79] This number overstates the number of affected issuers because some issuers have more than one security with priced quotes.

publish priced quotations when the annual review date occurs. Broker-dealers would be required to retain the information they collect for a period of not less than three years. Information collected under the Rule would not be kept confidential. Any agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

F. Request for Comments

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) Evaluate whether the proposed collection of information is necessary for the proposed performance of the functions of the agency, including whether the information will have practical utility;

(ii) Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected; and

(iv) Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. The Commission seeks data about quotations for covered OTC securities in OTC quotation mediums other than the OTC Bulletin Board, Pink Sheets and Yellow Sheets. The Commission asks for comments on its estimate of the number of issuers affected by the proposed Rule. The Commission also seeks comments on the time estimates made for broker-dealers and issuers to comply with the proposals' information collection requirements.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 3208, New Executive Office Building, Washington, D.C. 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, and refer to File No. S7–3–98. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release in the **Federal Register**, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of this publication.

VIII. Statutory Basis and Text of Proposed Amendments and Rule

The rule amendments are being proposed pursuant to Sections 3, 10(b), 15(c), 15(g), 17(a), and 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78c, 78j(b), 78o(c), 78o(g), 78q(a), and 78w(a).

List of Subjects in 17 CFR Part 240

Broker-dealers, Fraud, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule

In accordance with the foregoing, Title 17, chapter II, part 240 of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.15c2–11 and the section heading are revised to read as follows:

§ 240.15c2–11. Publication or submission of quotations without current information.

(a) *Unlawful activity.* As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for a broker or dealer, directly or indirectly, to publish or to submit for publication any quotation for a security in any quotation medium unless the broker or dealer complies with the provisions of this section.

(b) *Covered brokers or dealers.* A broker or dealer shall satisfy the requirements of this section prior to publishing or submitting for publication any one of the following kinds of quotations for a security in a quotation medium:

(1) An initial quotation;

(2) An initial or resumed quotation following:

(i) The lapse of five or more consecutive business days during which period the broker or dealer did not publish or submit for publication any quotations for the security in a quotation medium; or

(ii) The termination of a Commission trading suspension ordered pursuant to section 12(k) of the Act (15 U.S.C. 78*l*(k)) in any securities of the issuer; or

(3) A quotation at a specified price following:

(i) The anniversary date of the initial quotation by the broker or dealer; or

(ii) The date that is four months following the end of the issuer's fiscal year; or

(iii) In the case of a foreign private issuer, the date that is seven months following the end of the issuer's fiscal year.

(c) *Requirements.* A broker or dealer subject to paragraph (b) of this section shall:

(1) Review the information described in paragraphs (d) and (e) of this section;

(2) Determine that it has a reasonable basis under the circumstances for believing that the issuer information described in paragraph (d) of this section, when considered in conjunction with the supplemental information in paragraph (e) of this section, is accurate and current in all material respects, and that it is obtained from reliable sources; and

(3) Make a record of:

(i) The information required by paragraph (f) of this section;

(ii) The sources from which it obtained the information described in paragraphs (d) and (e) of this section;

(iii) The date that the broker or dealer reviewed the information required by this section; and

(iv) The person responsible for the broker or dealer's compliance with the requirements of this section.

(d) *Issuer information.* (1) *Issuers with a recent public offering.* For an issuer that has filed a registration statement under the Securities Act, other than a registration statement on Form F–6 (17 CFR 239.36), which became effective less than 90 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, the prospectus specified by section 10(a) of the Securities Act of 1933 (15 U.S.C. 77j(a)): *Provided,* That such registration statement has not thereafter been the subject of a stop order that is still in effect when the quotation is published or submitted.

(2) *Issuers with a recent Regulation A offering.* For an issuer that has filed a notification under Regulation A and was authorized to commence the offering less than 40 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, the offering circular provided for under Regulation A under the Securities Act (§§ 230.251 through 230.263): *Provided,* That the offering circular provided for under Regulation A has not thereafter become the subject of a suspension order which

is still in effect when the quotation is published or submitted.

(3) *Certain reporting issuers or exempted insurance companies.* For an issuer required to file reports pursuant to section 13 or 15(d) of the Act (15 U.S.C. 78m or 78o(d)) and that is current in filing such reports, or for an issuer of a security covered by section 12(g)(2) (B) or (G) of the Act (15 U.S.C. 78*l*(g)(2) (B) or (G)), the issuer's most recent annual report filed pursuant to section 13 or 15(d) of the Act or a copy of the annual statement referred to in section 12(g)(2)(G)(i) of the Act, together with any subsequent quarterly and current reports filed under the provisions of the Act by the issuer: *Provided,* That until such issuer has filed its first annual report pursuant to section 13 or 15(d) of the Act or annual statement referred to in section 12(g)(2)(G)(i) of the Act, the broker or dealer obtains and reviews a copy of the prospectus specified by section 10(a) of the Securities Act (15 U.S.C. 77j(a)) included in a registration statement filed by the issuer under the Securities Act that became effective within the prior 16 months, or a copy of any registration statement filed by the issuer under section 12 of the Act that became effective within the prior 16 months (other than a registration statement on Form F–6 (17 CFR 239.36)), together with any quarterly and current reports filed thereafter under section 13 or 15(d) of the Act.

(4) *Certain financial institutions.* For an issuer that is not required to file reports pursuant to section 13 or 15(d) of the Act (15 U.S.C. 78m or 78o(d)) and that is a bank or savings association, as those terms are defined in 12 U.S.C. 1813, a copy of the issuer's most recent annual report and any subsequent reports filed with its ''appropriate Federal banking agency'' or ''State bank supervisor,'' as those terms are defined in 12 U.S.C. 1813.

(5) *Certain foreign issuers.* For an issuer exempt from section 12(g) of the Act (15 U.S.C. 78*l*(g)) by reason of compliance with the provisions of § 240.12g3–2(b), the information furnished by the issuer to the Commission pursuant to § 240.12g3–2(b) since the beginning of the issuer's last fiscal year.

(6) *Other issuers.* For an issuer that is not covered by paragraphs (d)(1) through (d)(5) of this section: *Provided,* That this paragraph (d)(6) shall not be available in the case of an issuer that is required to file reports pursuant to section 13 or 15(d) of the Act (15 U.S.C. 78m or 78o(d)), the following information:

(i) The exact name of the issuer and any predecessor;

(ii) The address and telephone number of the issuer's principal executive offices;

(iii) The state of incorporation of the issuer, if it is a corporation;

(iv) The date on which the issuer's fiscal year ends;

(v) A description of each class of the issuer's securities outstanding, including its exact title; the par or stated value of the security; the number of securities or total principal amount outstanding; the class and the number of securities issuable upon exercise, exchange or conversion of a class of the issuer's securities; and the total number of securityholders of record for each class of the issuer's securities as of the end of the issuer's most recent fiscal year or a more recent date;

(vi) The exact title and class of the security that will be quoted;

(vii) The name, address and telephone number of the transfer agent;

(viii) A description of the issuer's business and facilities;

(ix) A description of products or services offered by the issuer;

(x) The full names and business addresses of the executive officers, directors, general partners, promoters, and control persons of the issuer, and the number of securities of each class of the issuer's securities that are beneficially owned by each such person as of the end of the issuer's last fiscal year or a more recent date;

(xi) One of the following alternatives:

(A) A description of any of the following events that occurred during the preceding five years involving any executive officer, director, general partner, promoter, or control person of the issuer:

(*1*) Conviction in a criminal proceeding or being named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

(*2*) Entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting involvement in any type of business, securities, commodities, or banking activities;

(*3*) Being found by a court of competent jurisdiction (in a civil action), the Commission, the Commodity Futures Trading Commission, or a state securities regulator to have violated federal or state securities or commodities law, and the judgment or finding has not been reversed, suspended, or vacated; and

(*4*) Entry of an order by a self-regulatory organization permanently or temporarily barring, suspending or otherwise limiting involvement in any type of business or securities activities;

(B) A statement from the issuer that none of these has occurred, if none has occurred; or

(C) A statement by the broker or dealer of the steps taken by it to obtain the information contained in paragraph (d)(6)(xi)(A) or (B) of this section from the issuer and that the issuer failed or refused to provide this information;

(xii) The following financial information:

(A) In the case of an issuer other than a foreign private issuer, the issuer's most recent balance sheet, statement of cash flows, statement of comprehensive income, and statement of operations (income), prepared in accordance with U.S. generally accepted accounting principles; or

(B) In the case of a foreign private issuer, the issuer's most recent balance sheet and statement of operations (income), and to the extent prepared by the issuer, statement of cash flows, statement of comprehensive income, and statement of changes in shareholders' equity, prepared in accordance with a comprehensive body of accounting principles.

(xiii) The same financial information required by paragraph (d)(6)(xii)(A) of this section for such part of the two preceding fiscal years as the issuer or any predecessor has been in existence, prepared in accordance with U.S. generally accepted accounting principles (except in the case of a foreign private issuer), *Provided* That in the case of an issuer that has emerged from reorganization pursuant to Chapter 11 of the Bankruptcy Code, the court-approved disclosure statement filed pursuant to 11 U.S.C. 1125 and the information required by this paragraph (d)(6)(xiii) from the date of the entry of the bankruptcy court order confirming the issuer's reorganization plan pursuant to 11 U.S.C. 1129, if the reorganization plan has been effective less than two years; and

(xiv) One of the following alternatives:

(A) A description of any of the following events involving the issuer or its predecessor, or any of its majority-owned subsidiaries, that have occurred in the two years preceding the publication or submission for publication of the quotation:

(*1*) A change in control of the issuer;

(*2*) Increase in equity securities involving 10% or more of the same class of securities outstanding at the time of the offering;

(*3*) Any merger, acquisition, or business combination;

(*4*) Acquisition or disposition of significant assets;

(*5*) Bankruptcy proceedings;

(*6*) Delisting by any securities exchange or the Nasdaq Stock Market; or

(B) A statement from the issuer that none of these events has occurred, if none has occurred; or

(C) A statement by the broker or dealer of the steps taken by it to obtain the information contained in paragraph (d)(6)(xi)(A) or (B) of this section from the issuer and that the issuer failed or refused to provide this information.

(e) *Supplemental information.* (1) A copy of any trading suspension order issued by the Commission pursuant to section 12(k) of the Act (15 U.S.C. 78*l*(k)) for any securities of the issuer or its predecessor (if any) during the 12 months preceding the date of the publication or submission of the quotation, or a copy of the public release issued by the Commission announcing such trading suspension order.

(2) A copy or a written record of any other material information (including adverse information) regarding the issuer which comes to the broker's or dealer's knowledge or possession before the publication or submission of a quotation.

(f) *Significant relationship information.* (1) A statement describing any direct or indirect affiliation between the issuer and the broker or dealer publishing or submitting the quotation for publication, or any of its associated persons.

(2) A statement whether the quotation is being published or submitted on behalf of any other broker or dealer, or any of its associated persons, and, if so, the name of such broker or dealer, or the associated person, and the terms of the arrangement.

(3) A statement whether the broker or dealer has received or has any arrangement to receive any monetary or other consideration from any person in connection with publishing the quotation and, if so, a description of the consideration and the name of the person providing the consideration.

(4) A statement whether the quotation directly or indirectly is being published or submitted for publication on behalf of the issuer, or any executive officer, director, general partner, promoter, control person, or any person, directly or indirectly the beneficial owner of more than 10 percent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person.

(g) *Exceptions.* The provisions of this section shall not apply to the publication or submission for publication of a quotation for:

(1) A security admitted to trading on a national securities exchange and which is traded on such an exchange on the same day as, or on the business day next preceding, the day the quotation is published;

(2) A security that is listed in the Nasdaq Stock Market, and such authorization is not suspended, terminated, or prohibited;

(3) An exempted security, as defined in section 3(a)(12) of the Act (15 U.S.C. 78c(a)(12)), or a municipal security as defined in section 3(a)(29) of the Act (15 U.S.C. 78c(a)(29)); or

(4) A security, solely on behalf of a customer (other than a person acting as or for a dealer), that represents the customer's order or indication of interest and does not involve the solicitation of the customer's order or interest.

(h) *Preservation of documents and information.* The broker or dealer shall preserve the information specified in paragraphs (d), (e), and (f) of this section in accordance with the provisions of § 240.17a–4(b)(11): *Provided, however,* That if the broker or dealer satisfied the requirements of paragraph (d) of this section by obtaining and reviewing such information on the EDGAR system, the broker or dealer shall be deemed to have preserved the information described in paragraph (d) of this section if the broker or dealer has the means to access such information electronically for the period described by § 240.17a–4(b)(11).

(i) *Information submitted to the NASD.* (1) At least three business days before the quotation is published, the broker or dealer shall submit to the NASD, in accordance with NASD rules, the information required in paragraphs (d), (e), and (f) of this section.

(2) For any security of an issuer included in paragraph (d)(3) of this section:

(i) A broker or dealer shall be in compliance with the requirement to obtain current reports filed by the issuer if the broker or dealer obtains all current reports filed with the Commission by the issuer as of a date up to three business days in advance of the earlier of the date of submission of the quotations to the quotation medium and the date of submission of information to the NASD pursuant to NASD rules; and

(ii) A broker or dealer shall be in compliance with the requirement to obtain the annual, quarterly, and current reports filed by the issuer, if the broker or dealer has made arrangements to receive all such reports when filed by the issuer and it has regularly received reports from the issuer on a timely basis.

(j) *Information available upon request.* A broker or dealer that publishes any quotation for a security pursuant to this section shall make the information specified in paragraphs (d), (e), and (f) of this section promptly available upon request to any person. Providing such information to others pursuant to this paragraph (j) shall not constitute a representation by such broker or dealer that the information is accurate, but it shall constitute a representation by such broker or dealer that the information is current in relation to the date recorded pursuant to paragraph (c)(3)(iii) of this section, that the broker or dealer has a reasonable basis under the circumstances for believing the information is accurate in all material respects, and that the information was obtained from sources which the broker or dealer has a reasonable basis for believing are reliable.

(k) *Definitions.* For purposes of this section:

(1) *Initial quotation* means the first quotation for a security published or submitted for publication in a quotation medium by the broker or dealer.

(2) *Issuer,* in the case of quotations for American Depositary Receipts, means the issuer of the deposited shares represented by such American Depositary Receipts.

(3) *NASD* means the National Association of Securities Dealers, Inc., including its wholly owned subsidiaries (including, but not limited to, NASD Regulation, Inc. and The Nasdaq Stock Market, Inc.).

(4) *Nasdaq Stock Market* means the Nasdaq National Market and the Nasdaq SmallCap Market, both operated by the Nasdaq Stock Market, Inc.

(5) *Promoter* has the same meaning contained in § 230.405 of this chapter.

(6) *Quotation* means any bid or offer at a specified price with respect to a security, or any indication of interest by a broker or dealer in receiving bids or offers from others for a security, or any indication by a broker or dealer that advertises its general interest in buying or selling a particular security.

(7) *Quotation medium* means any:

(i) System of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers; or

(ii) Publication or electronic communications network, or other device that is used by brokers or dealers to make known to others their interest in transactions in any security,

including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(8) *Securities Act* means the Securities Act of 1933 (15 U.S.C. 77a, *et seq.*).

(l) Unless the broker or dealer knows or has reason to know that more current information is available, the information specified in paragraph (d)(6) of this section will be presumed to be current, if:

(1) The balance sheet is as of a date less than 16 months before the publication or submission of the quotation, the statement of cash flows, statement of comprehensive income, and statement of operations (income) (and in the case of foreign issuers, the statement of changes in shareholders' equity) are for the 12 months preceding the date of such balance sheet; and if such balance sheet is not as of a date less than 6 months before the publication or submission of the quotation, it shall be accompanied by an additional statement of cash flows, statement of comprehensive income, and statement of operations (and in the case of foreign issuers, statement of changes in shareholders' equity) for the period from the date of such balance sheet to a date less than 6 months before the publication or submission of the quotation.

(2) Other information regarding the issuer specified in paragraph (d)(6) of this section is as of a date within 12 months prior to the publication or submission of the quotation.

(m) *Transition provision.* A broker or dealer that was publishing a quotation for a security on the business day immediately prior to [effective date of amendments in the final rule] may continue to publish quotations for such security without complying with paragraph (c) of this section until the occurrence of any of the events set forth in paragraphs (b)(2) or (b)(3) of this section.

(n) This section shall not prohibit any publication or submission of any quotation if the Commission, upon written request or upon its own motion, exempts such quotation either unconditionally or on specified terms and conditions, as not constituting a fraudulent, manipulative or deceptive practice comprehended within the purpose of this section.

3. Section 240.17a–4 is amended by adding paragraph (b)(11) to read as follows:

§ 240.17a–4. Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(b) * * *

(11) The records required to be obtained pursuant to § 240.15c2–11.

* * * * *

Dated: February 17, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–4460 Filed 2–24–98; 8:45 am]

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