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(c) *Definition of compensation.* For purposes of this section, *compensation* means, with respect to a transaction in a penny stock:

(1) If a broker is acting as agent for a customer, the amount of any remuneration received or to be received by it from such customer in connection with such transaction;

(2) If, after having received a buy order from a customer, a dealer other than a market maker purchased the penny stock as principal from another person to offset a contemporaneous sale to such customer or, after having received a sell order from a customer, sold the penny stock as principal to another person to offset a contemporaneous purchase from such customer, the difference between the price to the customer and such contemporaneous purchase or sale price; or

(3) If the dealer otherwise is acting as principal for its own account, the difference between the price to the customer and the prevailing market price.

(d) *Active and competitive* market. For purposes of this section only, a market may be deemed to be ''active and competitive'' in determining the prevailing market price with respect to a transaction by a market maker in a penny stock if the aggregate number of transactions effected by such market maker in the penny stock in the five business days preceding such transaction is less than twenty percent of the aggregate number of all transactions in the penny stock reported on a Qualifying Electronic Quotation System (as defined in 17 CFR 240.15g–3(c)(5)) during such five-day period. No presumption shall arise that a market is not ''active and competitive'' solely by reason of a market maker not meeting the conditions specified in this paragraph.

[57 FR 18034, Apr. 28, 1992]

§ 240.15g–5 Disclosure of compensation of associated persons in connection with penny stock transactions.

(a) *General.* It shall be unlawful for a broker or dealer to effect a transaction in any penny stock for or with the account of a customer unless the broker or dealer discloses to such customer, within the time periods and in the manner required by paragraph (b) of this section, the aggregate amount of cash compensation that any associated person of the broker or dealer who is a natural person and has communicated with the customer concerning the transaction at or prior to receipt of the customer's transaction order, other than any person whose function is solely clerical or ministerial, has received or will receive from any source in connection with the transaction and that is determined at or prior to the time of the transaction, including separate disclosure, if applicable, of the source and amount of such compensation that is not paid by the broker or dealer.

(b) *Timing.* (1) The information described in paragraph (a) of this section:

(i) Shall be provided to the customer orally or in writing prior to effecting any transaction with or for the customer for the purchase or sale of such penny stock; and

(ii) Shall be given or sent to the customer in writing, at or prior to the time that any written confirmation of the transaction is given or sent to the customer pursuant to 17 CFR 240.10b–10.

(2) A broker or dealer, at the time of making the disclosure pursuant to paragraph (b)(1)(i) of this section, shall make and preserve as part of its records, a record of such disclosure for the period specified in 17 CFR 240.17a–4(b).

(c) *Contingent compensation arrangements.* Where a portion or all of the cash or other compensation that the associated person may receive in connection with the transaction may be determined and paid following the transaction based on aggregate sales volume levels or other contingencies, the written disclosure required by paragraph (b)(1)(ii) of this section shall state that fact and describe the basis upon which such compensation is determined.

[57 FR 18034, Apr. 28, 1992]

§ 240.15g–6 Account statements for penny stock customers.

(a) *Requirement.* It shall be unlawful for any broker or dealer that has effected the sale to any customer, other than in a transaction that is exempt pursuant to 17 CFR 240.15g–1, of any security that is a penny stock on the last trading day of any calendar month, or

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any successor of such broker or dealer, to fail to give or send to such customer a written statement containing the information described in paragraphs (c) and (d) of this section with respect to each such month in which such security is held for the customer's account with the broker or dealer, within ten days following the end of such month.

(b) *Exemptions.* A broker or dealer shall be exempted from the requirement of paragraph (a) of this section under either of the following circumstances:

(1) If the broker or dealer does not effect any transactions in penny stocks for or with the account of the customer during a period of six consecutive calendar months, then the broker or dealer shall not be required to provide monthly statements for each quarterly period that is immediately subsequent to such six-month period and in which the broker or dealer does not effect any transaction in penny stocks for or with the account of the customer, *provided* that the broker or dealer gives or sends to the customer written statements containing the information described in paragraphs (d) and (e) of this section on a quarterly basis, within ten days following the end of each such quarterly period.

(2) If, on all but five or fewer trading days of any quarterly period, a security has a price of five dollars or more, the broker or dealer shall not be required to provide a monthly statement covering the security for subsequent quarterly periods, until the end of any such subsequent quarterly period on the last trading day of which the price of the security is less than five dollars.

(c) *Price determinations.* For purposes of paragraphs (a) and (b) of this section, the price of a security on any trading day shall be determined at the close of business in accordance with the provisions of 17 CFR 240.3a51–1(d)(1).

(d) *Market and price information.* The statement required by paragraph (a) of this section shall contain at least the following information with respect to each penny stock covered by paragraph (a) of this section, as of the last trading day of the period to which the statement relates:

(1) The identity and number of shares or units of each such security held for the customer's account; and

(2) The estimated market value of the security, to the extent that such estimated market value can be determined in accordance with the following provisions:

(i) The highest inside bid quotation for the security on the last trading day of the period to which the statement relates, multiplied by the number of shares or units of the security held for the customer's account; or

(ii) If paragraph (d)(2)(i) of this section is not applicable because of the absence of an inside bid quotation, and if the broker or dealer furnishing the statement has effected at least ten separate Qualifying Purchases in the security during the last five trading days of the period to which the statement relates, the weighted average price per share paid by the broker or dealer in all Qualifying Purchases effected during such five-day period, multiplied by the number of shares or units of the security held for the customer's account; or

(iii) If neither of paragraphs (d)(2)(i) nor (d)(2)(ii) of this section is applicable, a statement that there is ''no estimated market value'' with respect to the security.

(e) *Legend.* In addition to the information required by paragraph (d) of this section, the written statement required by paragraph (a) of this section shall include a conspicuous legend that is identified with the penny stocks described in the statement and that contains the following language:

> If this statement contains an estimated value, you should be aware that this value may be based on a limited number of trades or quotes. Therefore, you may not be able to sell these securities at a price equal or near to the value shown. However, the broker-dealer furnishing this statement may not refuse to accept your order to sell these securities. Also, the amount you receive from a sale generally will be reduced by the amount of any commissions or similar charges. If an estimated value is not shown for a security, a value could not be determined because of a lack of information.

(f) *Preservation of records.* Any broker or dealer subject to this section shall preserve, as part of its records, copies of the written statements required by

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paragraph (a) of this section and keep such records for the periods specified in 17 CFR 240.17a–4(b).

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

(1) The term *Quarterly period* shall mean any period of three consecutive full calendar months.

(2) The *inside bid quotation* for a security shall mean the highest bid quotation for the security displayed by a market maker in the security on a Qualifying Electronic Quotation System, at any time in which at least two market makers are contemporaneously displaying on such system bid and offer quotations for the security at specified prices.

(3) The term *Qualifying Electronic Quotation System* shall mean an automated interdealer quotation system that has the characteristics set forth in section 17B(b)(2) of the Act, or such other automated interdealer quotation system designated by the Commission for purposes of this section.

(4) The term *Qualifying Purchases* shall mean *bona fide* purchases by a broker or dealer of a penny stock for its own account, each of which involves at least 100 shares, but excluding any block purchase involving more than one percent of the outstanding shares or units of the security.

[57 FR 18034, Apr. 28, 1992]

§ 240.15g–8 Sales of escrowed securities of blank check companies.

As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for any person to sell or offer to sell any security that is deposited and held in an escrow or trust account pursuant to Rule 419 under the Securities Act of 1933 (17 CFR 230.419), or any interest in or related to such security, other than pursuant to a qualified domestic relations order as defined by the Internal Revenue Code of 1986, as amended (26 U.S.C. 1 *et seq.*), or Title I of the Employee Retirement Income Security Act (29 U.S.C. 1001 *et seq.*), or the rules thereunder.

[57 FR 18045, Apr. 28, 1992]

§ 240.15g–9 Sales practice requirements for certain low-priced securities.

(a) As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for a broker or dealer to sell a penny stock to, or to effect the purchase of a penny stock by, any person unless:

(1) The transaction is exempt under paragraph (c) of this section; or

(2) Prior to the transaction:

(i) The broker or dealer has approved the person's account for transactions in penny stocks in accordance with the procedures set forth in paragraph (b) of this section; and

(ii)(A) The broker or dealer has received from the person an agreement to the transaction setting forth the identity and quantity of the penny stock to be purchased; and

(B) Regardless of the form of agreement used to satisfy the requirements of paragraph (a)(2)(ii)(A) of this section, it shall be unlawful for such broker or dealer to sell a penny stock to, or to effect the purchase of a penny stock by, for or with the account of a customer less than two business days after the broker or dealer sends such agreement.

(b) In order to approve a person's account for transactions in penny stocks, the broker or dealer must:

(1) Obtain from the person information concerning the person's financial situation, investment experience, and investment objectives;

(2) Reasonably determine, based on the information required by paragraph (b)(1) of this section and any other information known by the broker-dealer, that transactions in penny stocks are suitable for the person, and that the person (or the person's independent adviser in these transactions) has sufficient knowledge and experience in financial matters that the person (or the person's independent adviser in these transactions) reasonably may be expected to be capable of evaluating the risks of transactions in penny stocks;

(3) Deliver to the person a written statement:

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