

REGULATION OF OVER-THE-COUNTER MARKETS

MAY 6, 1938.—Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

Mr. EICHER, from the Committee on Interstate and Foreign Commerce, submitted the following

REPORT

[To accompany S. 3255]

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (S. 3255) to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, to prevent acts and practices inconsistent with just and equitable principles of trade, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments recommended by the committee are as follows:

In subsection (f) of the amendment made by section 1 of the bill strike out “, but such withdrawal shall be subject to such appropriate terms and conditions for the orderly liquidation of such association as the Commission may prescribe”.

Amend section 2 of the bill to read as follows:

Sec. 2. Subsection (c) of section 15 of such Act, as amended, is amended to read as follows:

“(c) (1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

“(2) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably des-

signed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

"(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors (A) to provide safeguards with respect to the financial responsibility of brokers and dealers; (B) to regulate the manner, method, and place of soliciting business; and (C) to regulate the time and method of making settlements, payments, or deliveries."

Amend section 3 of the bill to read as follows:

Sec. 3. Subsection (b) of section 29 of such Act is amended by inserting before the period at the end thereof a colon and the following: "Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (3) of subsection (c) of Section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation."

In the amendment made by section 4 of the bill strike out "pursuant to clause (3), (4), or (5) of subsection (c)" and insert in lieu thereof "pursuant to paragraph (3) of subsection (c)".

I

GENERAL STATEMENT

A. INTRODUCTORY

Senate bill 3255 amends the Securities Exchange Act of 1934, as amended, by inserting a new section, section 15A, immediately after the present section 15; and by amending subsection (c) of section 15, subsection (b) of section 29, section 32, and subsection (a) of section 17. In its essentials, the new section 15A would set up a system for cooperative regulation of the over-the-counter markets, through the activities of voluntary associations of investment bankers, dealers, and brokers doing business in these markets, under appropriate governmental supervision. The proposed amendment of subsection (c) of section 15 of the Securities Exchange Act would clarify and strengthen the direct regulatory powers over the over-the-counter markets embodied in the present subsection (c), and would provide for certain additional direct powers which are desirable in the public interest. The changes in sections 29, 32, and 17 are supplementary to the new section 15A and the changes in subsection (c) of section 15.

B. SCOPE OF THE PROBLEM

1. *Importance of the over-the-counter markets.*—Under the Securities Exchange Act of 1934, the over-the-counter markets are deemed to include all transactions in securities which take place otherwise than upon a national securities exchange. These markets are immense, the activities embraced therein are varied, and they are of the utmost importance to the national economy.

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 ...of the mails or of any means or instrument of any security (other than an exempted acceptance, or commercial bill) otherwise, in contravention of such rules and describe as necessary or appropriate in the (A) to provide safeguards with of brokers and dealers; (B) to regulate the business; and (C) to regulate the time and ... or deliveries."

read as follows:

of such Act is amended by inserting before the following: "Provided, (A) That no subsection because of any violation of any paragraph (3) of subsection (c) of Section shall be deemed to be void by reason in reliance upon this subsection, by or dealer sells, or from or for whom any violation of any rule or regulation promulgated by the Commission under subsection (c) of section 15 of this Act within one year after the discovery that such violation occurred, and within three years after such violation."

Section 4 of the bill strike out "pursuant to subsection (c)" and insert in lieu thereof "subsection (c)".

STATEMENT

INTRODUCTORY

Securities Exchange Act of 1934, as amended, section 15A, immediately after subsection (e) of section 15, section 32, and subsection (a) of section 15A would set up a system for over-the-counter markets, through the use of investment bankers, dealers, and brokers, under appropriate government supervision. The amendment of subsection (e) of section 15 of the Act would clarify and strengthen the regulation of the over-the-counter markets and would provide for certain provisions which are desirable in the public interest. Sections 16 and 17 are supplementary to the new section (e) of section 15.

THE PROBLEM

Over-the-counter markets.—Under the Securities Exchange Act of 1934, over-the-counter markets are deemed to be those in which take place otherwise than on an exchange. These markets are immense, varied, and they are of the utmost importance.

Currently, some 6,766 firms of brokers and dealers are registered with the Commission as transacting business in the over-the-counter markets. For purposes of comparison, it may be pointed out that there are only 1,975 members of the New York Stock Exchange. Over-the-counter quotations for at least 60,000 separate issues of securities are published in services to which brokers and dealers subscribe, whereas only about 6,000 separate issues of stocks and bonds are admitted to trading on all the stock exchanges of the country.

Moreover, a great deal of trading takes place over the counter even in securities which are admitted to trading upon exchanges. This is particularly true of high-grade bonds and preferred stocks; in fact, many issues of high-grade bonds and preferred stocks are not admitted to trading upon any exchange, and have their only market over the counter. For example, an estimate indicates that, as of the summer of 1937, insurance company securities with an approximate market value of about \$343,000,000 were admitted to trading upon exchanges, whereas some \$1,209,000,000 of insurance company securities—roughly four times the previous figure—were not admitted to trading upon any exchange, and thus enjoyed their only market over the counter. Moreover, the primary operations of the great underwriting houses take place over the counter. Thus, the over-the-counter markets not only provide the medium for an immense volume of trading in a great variety of securities, but they also provide the principal channel by which the savings of the Nation flow into new financing. It is scarcely necessary to state the importance of the process by which the financial requirements of expanding industry are met through the public sale of securities to investors. The process of distributing such securities takes place on a national scale over the counter.

The over-the-counter markets in their day-to-day operation may be envisaged as a network of telephone and telegraph wires connecting dealers in all parts of the country. One might almost describe the interstate telephone as a trade symbol for this highly important business. The mails, of course, are used extensively and continuously. Thus, the over-the-counter markets are national in a dual sense: first, because of their immense importance to the national economy; second, because the actual operations of these markets are interconnected on a national scale.

2. Importance of regulating the over-the-counter markets in relation to the regulation of exchanges.—The importance of the over-the-counter markets in and of themselves would suffice to justify a reasonable system of regulation. Effective regulation of these markets is, moreover, imperative to prevent the evasion of the system of regulation of exchange trading embodied in the Securities Exchange Act of 1934. This was recognized by the Congress in the original enactment of that act. Thus, the report of the Senate Committee on Banking and Currency (S. Rept. No. 792, 73d Cong., 2d sess.) accompanying the bill which became the Securities Exchange Act of 1934 included the following statements:

It has been deemed advisable to authorize the Commission to subject such activities [i. e., trading in the over-the-counter markets] to regulation similar to that prescribed for transactions on organized exchanges. This power is vitally necessary to forestall the widespread evasion of stock-exchange regulation by the withdrawal of securities from listing on exchanges, and by transferring trading therein to "over-the-counter" markets where manipulative evils could continue to flourish, unchecked by any regulatory authority (p. 6).

Similarly, the report of the House Committee on Interstate and Foreign Commerce (H. Rept. No. 1383, 73d Cong., 2d sess.) accompanying the House bill for the regulation of exchanges quotes with approval the following statement from the report of the Twentieth Century Fund on Stock Market Control:

To leave the over-the-counter markets out of a regulatory system would be to destroy the effects of regulating the organized exchanges (p. 16).

These statements remain no less true today.

3. *Abuses in the over-the-counter markets.*—A single phase of the administrative experience of the Securities and Exchange Commission suffices to illustrate the extent of the problem of policing the submarginal element among over-the-counter brokers and dealers. In 1937, the Commission made investigations in three areas outside the largest financial centers—in Cleveland, Detroit, and the Pacific Northwest. A few attorneys and accountants were sent to these areas to inquire into certain complaints and to make a brief survey. In the space of a few months 13 individuals were criminally convicted, 16 more were placed under indictment, 17 corporations and 41 more individuals were enjoined, and 2 firms were expelled or obliged to withdraw from national securities exchanges, all for elementary violations of the law. These results produced by so limited a staff within three restricted areas in so short a time speak for themselves. We are advised that the Commission has every reason to believe that the problem revealed thereby exists in other regions as well.

4. *Nature of the problem of regulation.*—The problem of regulation of the over-the-counter markets has three aspects: First, to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal element in the industry; second, to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market; and, third, to afford to the investor an economic service the efficiency of which will be commensurate with its economic importance, so that the machinery of the Nation's markets will operate to avoid the misdirection of the Nation's savings, which contributes powerfully toward economic depressions and breeds distrust of our financial processes.

The committee believes that there are two alternative programs by which this problem could be met. The first would involve a pronounced expansion of the organization of the Securities and Exchange Commission; the multiplication of branch offices; a large increase in the expenditure of public funds; an increase in the problem of avoiding the evils of bureaucracy; and a minute, detailed, and rigid regulation of business conduct by law. It might very well mean expanding the present process of registration of brokers and dealers with the Commission to include the proscription not only of the dishonest, but also of those unwilling or unable to conform to rigid standards of financial responsibility, professional conduct, and technical proficiency. The second of these alternative programs, which the committee believes distinctly preferable to the first, is embodied in S. 3255. This program is based upon cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary

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powers of direct regulation. In the concept of a really well organized and well-conducted stock exchange, under the supervision provided by the Securities Exchange Act of 1934, one may perceive something of the possibilities of such a program.

C. LEGISLATIVE BACKGROUND

In the Securities Exchange Act of 1934, as originally enacted, the over-the-counter markets were dealt with, in brief outline, in a single section. The brevity and generality of this treatment arose from a realistic recognition of the great difficulties of working out in any detail a suitable plan of regulation at that time, in view of the fact that so little was then known concerning these markets. But, though the Congress did not at that time have before it a sufficient record of data or experience to enable it to determine upon a detailed plan of regulation, it clearly set forth the objectives of and the standards for such regulation. Section 15, in its original form, expressly contemplated the adoption by the Securities and Exchange Commission of rules and regulations concerning the over-the-counter markets "necessary or appropriate in the public interest * * * to insure to investors protection comparable to that provided by and under authority of this title in the case of national securities exchanges". To that end, the Commission was authorized to adopt rules and regulations providing "for the regulation of all transactions by brokers and dealers on any such market, for the registration with the Commission of dealers and/or brokers making or creating such a market, and for the registration of the securities for which they make or create a market."

After a year and a half of administrative experience under the original section 15, that section was, in May 1936, amended to embody the results of that experience. In consequence, section 15 in its present form is far more specific than in its original form. Since that amendment, another year and a half of administrative experience has been accumulated. This experience has both demonstrated the need and laid the foundation for a further step, which is taken in the bill now under consideration. In the judgment of the committee this bill, like the amendment of section 15 enacted in May 1936, does not enlarge the objectives or the outline of regulatory functions initially set forth in the original section 15. On the contrary, it represents the essential process of filling in and implementing the original outline in order to make possible the realization of the original objectives.

D. GROWTH OF THE IDEA OF COOPERATIVE REGULATION

The plan of cooperative regulation embodied in S. 3255 rests upon 3 years of gradual and orderly growth. Almost from its inception, the Commission conducted extended conferences with representatives of various associations of investment bankers, dealers, and brokers from all parts of the country. About 3 years ago a conference committee was formed, representative of the industry, to obtain the views of investment bankers, dealers, and brokers as to the desirability of perfecting a permanent scheme of organization for the purposes hereinafore discussed. As a result of the activities of the conference committee, there came into existence in 1936 an organization known as the Investment Bankers Conference, Inc. This organization has

enrolled and maintained a membership, the committee is informed, of some 1,700 firms situated in all parts of the United States. There are likewise in existence in the country a number of other associations of brokers and dealers which have for some time exercised a degree of supervision over the conduct of their members.

The committee believes that these years of experiment in organization among members of the industry and in the development of their relations with the Commission provide a sound and practical basis for the program embodied in S. 3255.

II

ANALYSIS OF THE BILL BY SECTIONS

A. SECTION 1

Section 1 would amend the Securities Exchange Act of 1934, as amended, by inserting after section 15 thereof a new section, section 15A.

1. *Subsection (a) of section 15A.*—This subsection provides that associations of brokers or dealers may register with the Commission as national securities associations pursuant to subsection (b), or as affiliated securities associations pursuant to subsection (d), under stated terms and conditions, upon the filing of certain specified data. This subsection is similar to subsection (a) of section 6 of the Securities Exchange Act of 1934, as amended, which provides for the registration of national securities exchanges, except that associations which do not register are not denied the use of the mails or instrumentalities of interstate commerce. Thus, the formation of associations and application for registration by them are matters of voluntary choice. It should be noted that membership by a broker or dealer in such a registered securities association does not supersede the obligation of individual brokers or dealers to register under section 15 of the Exchange Act.

2. *Subsection (b) of section 15A.*—This subsection sets forth requirements which an association of brokers or dealers must satisfy to qualify for the registration as a national securities association. The requirements are enumerated in 10 paragraphs, a discussion of which follows:

(a) Paragraph (1) of subsection (b): This paragraph limits eligibility for registration as a national securities association to such associations as are a proper subject of national concern. It is contemplated that associations, to qualify under this paragraph, should either be actually Nation-wide in scope or should represent a substantial and economically cohesive region. Without suggesting that such regions should necessarily be identical with the districts under the Federal Reserve System, such districts may perhaps be cited as an illustration of the type of region which would be appropriate.

(b) Paragraph (2) of subsection (b): This paragraph limits eligibility for registration as a national securities association to associations of which the general pattern of organization and general character are such as to satisfy the Commission that they will be able effectually to discharge their function of carrying out the purposes of the new section 15A within the framework of the Exchange Act.

(c) Paragraph (3) of subsection (b): The broad purpose of this paragraph is to make sure that all brokers and dealers who conduct

membership, the committee is informed, of all parts of the United States. There are in every country a number of other associations of this kind for some time exercised a degree of control over their members.

In these years of experiment in organization in the industry and in the development of their own methods provide a sound and practical basis for the new section 15A.

II

THE BILL BY SECTIONS

A. SECTION 1

The Securities Exchange Act of 1934, as amended, section 15 thereof a new section, section 15A.

Section 15A.—This subsection provides that any broker or dealer may register with the Commission as a member of a registered securities association pursuant to subsection (b), or as a member of a national securities association pursuant to subsection (d), under the filing of certain specified data. Subsection (a) of section 6 of the Securities Exchange Act of 1934, which provides for the registration of associations which do not have the character of the mails or instrumentalities of interstate commerce, is not affected by the formation of associations and applications for membership by a broker or dealer in such a way as to supersede the obligation of such broker or dealer to register under section 15 of the Securities Exchange Act of 1934.

Section 15A.—This subsection sets forth requirements for brokers or dealers to qualify for membership in a registered securities association. The requirements are set forth in paragraphs (a) through (g), a discussion of which follows: Paragraph (a) limits eligibility for membership in a national securities association to such associations of national concern. It is contemplated that associations which do not have a scope or should represent a substantial part of the business of a district or region. Without suggesting that such associations may perhaps be cited as an example of which would be appropriate.

Paragraph (b): This paragraph limits eligibility for membership in a registered securities association to associations of national concern and general character or character such that they will be able effectively to carry out the purposes of the new section 15A of the Exchange Act.

Paragraph (c): The broad purpose of this paragraph is to exclude from membership all brokers and dealers who conduct

an honest and responsible business shall be eligible for membership in some association. Particular associations may, however, by their rules restrict membership therein on such specified geographical basis, such specified basis relating to the type of business done by their members, or on such other specified and appropriate basis as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of the new section 15A. Thus, an association, membership in which is limited to brokers and dealers from some designated geographical region, or to brokers and dealers transacting business exclusively in a particular class of securities, may be eligible for registration. Any geographical restrictions upon membership, however, must be broad enough to satisfy the requirements of paragraph (1).

Paragraph (d): Paragraph (4) of subsection (b): The broad purpose of this paragraph is to exclude from membership in any registered securities association any broker or dealer who has disqualified himself by improper conduct. Thus, a broker or dealer may not be admitted to or continued in membership in a registered securities association (except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct) if he has been and is expelled or suspended from another registered securities association for a serious infraction of its rules; or if he has been and is expelled or suspended from a national securities exchange for a serious infraction of its rules; or if an order of the Commission is in effect denying or revoking his registration pursuant to section 15 of the Exchange Act; or if an order of the Commission is in effect expelling or suspending him from membership in a registered securities association or a national securities exchange; or, finally, if his conduct while employed by, acting for, or directly or indirectly controlling or controlled by a broker or dealer, was a cause which contributed to any suspension, expulsion, or order of the character described above which is in effect with respect to such broker or dealer. To prevent the evasion of these requirements, this paragraph also provides that a broker or dealer shall be ineligible for membership in a registered securities association if any person who is currently a partner, officer, director, or branch manager of such broker or dealer (or who currently occupies a similar status or performs similar functions) or who currently controls or is controlled by such broker or dealer, is subject to any suspension, expulsion, or order of the kind described above, or was a cause of any such suspension, expulsion, or order which is currently in effect.

Paragraph (e): Paragraph (5) of subsection (b): This paragraph is designed to assure to each member of a registered securities association reasonable representation in all phases of its operations.

Paragraph (f): Paragraph (6) of subsection (b): This paragraph has a dual purpose: First, to provide that the total of dues assessed against the members of an association shall not exceed an amount necessary to defray reasonable expenses of administration; second, to provide that such dues shall be fairly allocated among the members of the association.

Paragraph (g): Paragraph (7) of subsection (b): This paragraph outlines the functions for the accomplishment of which registered securities associations are expected to accept responsibility. To be eligible for registration, the rules of an association must be designed to prevent fraudulent and manipulative acts and practices, to provide safeguards

against unreasonable profits or unreasonable rates of commissions or other charges, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market. As safeguards against abuse, and to make clear that activities of associations under this paragraph are to be consistent with the operation of free and open markets, this paragraph provides that the rules of an association may not be designed to permit unfair discrimination between customers, or issuers, or brokers or dealers, nor to fix minimum profits, nor to impose any schedule of prices, nor to fix minimum rates or impose any schedule of commissions, allowances, discounts, or other charges. Thus, to provide safeguards against unreasonable profits, it is contemplated that associations may adopt rules designed to prevent each member thereof from exacting in any particular transaction a profit which reasonable men would agree was unconscionable in the light of all of the concrete facts and circumstances of that transaction; but an association, whether in a bona fide attempt to prevent or under the pretext of preventing unreasonable profits, may not impose any schedule of prices or commissions.

(h) Paragraph (8) of subsection (b): This paragraph limits eligibility for registration to associations, the rules of which provide that members shall be appropriately disciplined for violations of its rules. Disciplining may be in the form of expulsion, suspension, fine, censure, or any other fitting penalty. The form of discipline in any case must be appropriate to the particular violation.

(i) Paragraph (9) of subsection (b): This paragraph outlines the essential elements of a fair and orderly procedure to which associations must adhere in proceedings to discipline members or to deny membership to applicants. It is contemplated that the exact procedure will be defined by the rules of the association, within the framework set forth in this paragraph.

(j) Paragraph (10) of subsection (b): This paragraph provides simply that the requirements of subsection (c), to the extent that these may be applicable, must be satisfied.

3. *Subsection (c) of section 15A.*—Under this subsection, an association registered as a national securities association pursuant to subsection (b) may be required or permitted to provide for the admission of an association registered as an affiliated securities association pursuant to subsection (d) to participation in such national securities association as an affiliate, upon certain terms and conditions. The purpose of this paragraph is to enable soundly organized associations of brokers and dealers which are local in character, and hence not eligible for registration as national securities associations pursuant to subsection (b), to retain their identity as registered associations, if, by affiliation with a national securities association, they bring themselves within a sphere which is a proper subject of national concern and make possible coordinated administration.

4. *Subsection (d) of section 15.1.*—This subsection sets forth requirements which must be satisfied by a local association which is seeking registration as an affiliated securities association. In general, these requirements are parallel to those set forth in subsection (b); but there are in addition certain requirements which are applicable only to this kind of association.

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or unreasonable rates of commissions or and equitable principles of trade, and, and the public interest, and to remove the mechanism of a free and open market. and to make clear that activities of are to be consistent with the opera- this paragraph provides that the rules designed to permit unfair discrimination or brokers or dealers, nor to fix minimum of prices, nor to fix minimum rates commissions, allowances, discounts, or other safeguards against unreasonable profits, may adopt rules designed to pre- exacting in any particular transaction would agree was unconscionable in the and circumstances of that transaction; bona fide attempt to prevent or under reasonable profits, may not impose any

tion (b): This paragraph limits eligi- tions, the rules of which provide that e disciplined for violations of its rules. of expulsion, suspension, fine, censure, the form of discipline in any case must violation.

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tion (b): This paragraph provides of subsection (c), to the extent that be satisfied.

Under this subsection, an associa- tities association pursuant to sub- permitted to provide for the admis- as an affiliated securities association participation in such national securities certain terms and conditions. The cable soundly organized associations y local in character, and hence not securities associations pursuant to entity as registered associations, if, tities association, they bring them- proper subject of national concern ministration.

This subsection sets forth require- s local association which is seeking files association. In general, these e set forth in subsection (h); but elements which are applicable only

5. *Subsection (e) of section 15A.*—This subsection relates to the mechanics of granting or denying registration of associations pursuant to subsection (b) and subsection (d).

6. *Subsection (f) of section 15A.*—Under this subsection, amended as proposed, a registered securities association may, upon such reasonable notice as the Commission may prescribe as necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal in due form.

7. *Subsection (g) of section 15A.*—This subsection provides that any disciplinary action taken by a registered securities association against any member, and any action taken by such association denying admission to an applicant for membership, shall be subject to review by the Commission. Application to the Commission for review, or the institution of review by the Commission on its own motion, automatically stays the action of the association pending review by the Commission pursuant to subsection (h).

8. *Subsection (h) of section 15A.*—This subsection sets forth the essential elements of the procedure to be followed by the Commission in reviewing any disciplinary action or any action denying membership which has been taken by a registered securities association.

9. *Subsection (i) of section 15A.*—Broadly stated, under this subsection, a registered securities association may by its rules provide that no member thereof shall do business with any broker or dealer who is not a member of any registered securities association, except at the same prices, for the same commissions or fees, and on the same terms and conditions as are accorded to the general public by such member. Thus, it is contemplated that exclusion from membership in a registered securities association will be attended and implemented by economic sanctions. In this respect, exclusion from such an association would be comparable in effect to expulsion from a national securities exchange. It is these economic sanctions which would make possible effective discipline within the association.

It should be noted that nothing in this paragraph purports to authorize an association by its rules to prescribe any uniform differences between prices charged or discounts allowed to brokers and dealers, on the one hand, and members of the public, on the other hand, to which members of the association must adhere. Any such rule would be in derogation of paragraph (7) of subsection (b). The individual member is left free to determine his own business policy, but, insofar as he differentiates in prices, discounts, and other charges or allowances between brokers and dealers and members of the public, the rules of the association may require him to classify "nonmember brokers or dealers" with members of the public.

10. *Subsection (j) of section 15A.*—This subsection requires registered securities associations to file with the Commission in accordance with such rules and regulations as the Commission may prescribe any information or documents necessary to keep current or to supplement the original registration statement and documents filed therewith, as well as copies of any changes in or additions to the rules of the association. No change in or addition to the rules of a registered securities association shall take effect until the thirtieth day after filing or until such earlier date as the Commission may determine; and the Commission is empowered and directed by order to prevent such change or addition from taking effect, unless such change or

addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

11. *Subsection (k) of section 15A.*—Under this subsection, the Commission is authorized by order to abrogate any rule of a registered securities association, after appropriate notice and opportunity for hearing, if this appears to the Commission to be necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or otherwise to protect investors or effectuate the purposes of this title. The Commission may, moreover, by order alter or supplement the rules of an association with respect to four enumerated subjects, each of which relates to the organization and operation of the association as such, and not to the business conduct of the individual members; but the Commission may thus alter or supplement the rules of an association only if it has first in writing requested the association to adopt the specified alteration or supplement, and only after appropriate notice and opportunity for hearing.

12. *Subsection (l) of section 15A.*—Under this subsection the Commission is authorized in appropriate cases, upon specified terms and conditions, and after appropriate notice and opportunity for hearing, by order to suspend or revoke the registration of a registered securities association, to suspend or expel members from a registered securities association, or to remove any officer or director of a registered securities association. These supervisory powers are designed to prevent abuse, and to enable the Commission effectually to discharge its role in this scheme of cooperative regulation.

13. *Subsection (m) of section 15A.*—This subsection provides that section 15A shall not be construed to apply with respect to transactions by brokers or dealers in exempted securities. "Exempted securities" are defined by section 3 (a) (12) of the Exchange Act to include various forms of Government, State, municipal, and other public securities.

14. *Subsection (n) of section 15A.*—This subsection provides that if any provision of section 15A should be in conflict with any provision of any law of the United States in force on the date when the bill under consideration takes effect, the provision of section 15A shall prevail.

B. SECTION 2

Section 2, amended as proposed by the committee, amends subsection (c) of section 15 of the Securities Exchange Act of 1934, as amended. In effect, two new paragraphs are added to the present subsection (c); the present subsection (c) becomes paragraph (1) of the proposed new subsection (c), and the two new paragraphs are numbered (2) and (3), respectively. Subsection (c) relates to the direct powers of the Commission to adopt rules generally applicable to over-the-counter brokers and dealers.

As has been explained, paragraph (1) of the proposed new subsection (c) is identical with the present subsection (c), under which the Commission has adopted rules and regulations which have withstood the test of experience and have met with the approval of representative groups of brokers and dealers subject thereto. It is contemplated that rules of similar character and additional appropriate rules will be adopted under paragraph (1) of the proposed new subsection (c).

tion to be consistent with the requirements of section (d).

15A.—Under this subsection, the Commission is empowered to abrogate any rule of a registered securities association, upon appropriate notice and opportunity for hearing, if the Commission to be necessary or appropriate in the public interest, to protect investors or effectuate the purposes of the Act may, moreover, by order alter or amend any rule of a registered securities association with respect to four enumerated subjects: (1) the organization and operation of the association; (2) the business conduct of the individual members; (3) the manner in which the association may thus alter or supplement the rules; and (4) if it has first in writing requested the association to alter or supplement the rules, and only after the association has had an opportunity for hearing.

15A.—Under this subsection the Commission is empowered, upon specified terms and conditions, to suspend the registration of a registered securities association, upon appropriate notice and opportunity for hearing, if the Commission to be necessary or appropriate in the public interest, to protect investors or effectuate the purposes of the Act may, moreover, by order alter or amend any rule of a registered securities association with respect to four enumerated subjects: (1) the organization and operation of the association; (2) the business conduct of the individual members; (3) the manner in which the association may thus alter or supplement the rules; and (4) if it has first in writing requested the association to alter or supplement the rules, and only after the association has had an opportunity for hearing.

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C. SECTION 2

Section 2, amended as proposed by the committee, amends subsection (c) of section 17 of the Securities Exchange Act of 1934, as amended, by adding two new paragraphs and by striking the first paragraph. Paragraph (1) of subsection (c) becomes paragraph (1) of subsection (c), and the two new paragraphs are paragraphs (2) and (3) of subsection (c) respectively. Subsection (c) relates to the duties of registered securities dealers to adopt rules generally applicable to their members.

Paragraph (1) of the proposed new subsection (c) of section 17 of the Securities Exchange Act of 1934, under which the Commission is empowered to make such regulations which have withstood the test with the approval of representative members of the industry, is subject thereto. It is contemplated that the Commission may make such additional appropriate rules as may be necessary or appropriate in the public interest, to protect investors or effectuate the purposes of the proposed new subsection (c).

Paragraph (2) of the proposed new subsection (c), which does not apply to transactions in exempted securities, clarifies and broadens the power of the Commission by rules and regulations to prevent fraudulent, manipulative, and deceptive acts and practices and fictitious quotations.

Paragraph (3) of the proposed new subsection (c), which likewise does not apply to transactions in exempted securities, empowers the Commission by rule and regulation to take action against certain other abuses and to promote orderly and efficient business practices in connection with specified subjects.

The need of these additional powers has been demonstrated by the administrative experience of the Commission. Thus, paragraphs (2) and (3) represent a necessary step forward toward realizing the original objectives and implementing the original standards of regulation set forth in section 15 of the Exchange Act in its original form.

C. SECTION 3

Section 3, amended as proposed by the committee, amends subsection (b) of section 29 of the Exchange Act to provide that contracts entered into in violation of any rule or regulation under paragraph (3) of the proposed new subsection (c) shall not be void by reason of subsection (b) of section 29, and that no contract is to be deemed void by reason of this subsection in an action maintained in reliance upon the subsection involving a violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of section 15 (c), unless such action is brought within 1 year after discovery that the sale or purchase involves such violation and within 3 years after such violation.

D. SECTION 4

The committee recommends that section 4 be amended by striking the words "pursuant to clause 3, 4, or 5 of subsection (c)" and substituting the words "pursuant to paragraph (3) of subsection (c)." This change follows as a matter of course from the change in the proposed new subsection (c), which has been discussed above: paragraph (3) of subsection (c), as amended in accordance with the recommendation of the committee, corresponds in substance to clauses 3, 4, and 5 of the proposed new subsection (c) embodied in section 2 of the bill as passed by the Senate.

E. SECTION 5

This section amends subsection (a) of section 17 of the Exchange Act to subject every registered securities association to the same duties in regard to the keeping of records and the making of reports as, under the terms of that subsection, now devolve upon every registered broker or dealer, every national securities exchange, every member of any national securities exchange, and every broker or dealer who transacts a business in securities through the medium of any such member.

CHANGES IN EXISTING LAW

In compliance with paragraph 2a of rule XIII of the Rules of the House of Representatives, changes in the Securities Exchange Act of 1934 made by the bill are shown as follows: Existing law proposed

to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman.

Sec. 15. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

(b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as its own.

If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date thereof, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager or such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, as amended, or of this title, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration, for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after

such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (h).

(A) (1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant, shall (A) find that such member has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and (B) shall determine that such acts or practices, or omission to act, and in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission shall determine that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

(3) In any proceeding to review the denial of membership in a registered securities association, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, shall determine that the specific grounds on which such denial is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein.

(i) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

(2) For the purposes of this subsection, the term "nonmember broker or dealer" shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association, except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any registered securities association any dealer's discount, allowance, commission, or special terms.

(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (i).

(k) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or to effectuate the purposes of this title.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of

Commission may determine. Application to the Commission of review by the Commission on its own motion, until an order is issued upon such review pur-

ev disciplinary action taken by a registered securities association, if the Commission, after appropriate notice and consideration of the record before the association and upon review, shall (A) find that such member has committed such act, as the association has found, and (B) shall determine that such acts or practices, or of such rules of the association as have been designated, the Commission shall by order dismiss the Commission that such action should be modified or this subsection. The Commission shall likewise prohibit, or the omission of any act required, or inconsistent with just and equitable principles of trade appears to the Commission that the evidence does not justify (A), or if the Commission shall determine that such act has been engaged in are not prohibited by the association, or that such act as is found to have been committed rule or rules, the Commission shall by order

and opportunity for hearing, the Commission finds such member is excessive or oppressive, having due regard to the facts, shall by order cancel, reduce, or require the

the denial of membership in a registered securities association after appropriate notice and hearing, and upon the association and such other evidence as it may have specific grounds on which such denial is based in this section, the Commission shall by order dismiss the Commission shall by order set aside the action of the association to the applicant broker or dealer to membership

securities association, may provide that no member broker or dealer (as defined in paragraph (2) of prices, for the same commissions or fees, and on an equal basis by such member accorded to the general public. In this section, the term "nonmember broker or dealer" shall include use of the mails or of any means or instrumentality of any transaction in, or to induce the purchase of any security, other than on a national securities exchange, who is not a member of a registered securities association, except a broker or dealer who is a member of a national securities association, or commercial bills. This section shall be so construed or applied as to prevent any association from granting to any other member of the association a discount, allowance, commission, or

association shall file with the Commission in accordance with the Commission may prescribe as necessary for the protection of investors, copies of any rules of the association, and such other information as the Commission may require to keep current or to supplement the information filed pursuant to subsection (a). Any change in the rules of a registered securities association shall take effect upon filing thereof with the Commission, or upon such date as the Commission shall determine, unless the Commission shall enter an order to the Commission to be consistent with subsection (d).

and by order to abrogate any rule of a registered securities association after appropriate notice and opportunity for hearing, if the Commission determines that such abrogation is necessary or appropriate in the public interest, to assure a fair representation of its interests or otherwise to protect investors or effectuate the purposes of this section.

may require any registered securities association to supplement its rules with respect to any of

the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to (1) The basis for, and procedure in connection with, the denial of membership or the disciplining of members; (2) the method for adoption of any change in or addition to the rules of the association; (3) the method of choosing officers and directors; and (4) affiliation between registered securities associations.

(1) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section;

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof who the Commission finds (A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder, or (B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation;

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

(m) Nothing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail.

Sec. 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

(b) Any broker, dealer, or other person extending credit who is subject to the rules and regulations prescribed by the Federal Reserve Board pursuant to this title shall make such reports to the Board as it may require as necessary or appropriate to enable it to perform the functions conferred upon it by this title. If any such broker, dealer, or other person shall fail to make any such report or fail to furnish full information therein, or, if in the judgment of the Board it is otherwise necessary, such broker, dealer, or other person shall permit such inspections to be made by the Board with respect to the business operations of such broker, dealer, or other person as the Board may deem necessary to enable it to obtain the required information.

Sec. 20. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or [regulation.] regulation. *Provided, That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to clause (3), (4), or (5) of subsection (c) of section 15 of this title, except insofar as the Commission, having determined that such action is necessary or appropriate for the protection of investors, shall have expressly provided in such rule or regulation that the provisions of this subsection shall apply in the case of any violation thereof.*

(c) Nothing in this title shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this title, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this title or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this title or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

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 Sec. 32. (a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than \$10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding \$500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

(b) Any issuer which fails to file information, documents, or reports pursuant to an undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title shall forfeit to the United States the sum of \$100 for each and every day such failure to file shall continue. Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

(c) *The provisions of this section shall not apply in the case of any violation of any rule or regulation prescribed pursuant to clause (3), (4), or (5) of subsection (c) of section 15 of this title, except a violation which consists of making, or causing to be made, any statement in any report or document required to be filed under any such rule or regulation, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact.*

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