

# **“PENNY STOCK RISK DISCLOSURE DOCUMENT”**

**(From Schedule 15G\*)**

**Pursuant to SEC Rule 15g-2 of the Securities Enforcement remedies and Penny Stock Reform Act of 1990.**

## **IMPORTANT INFORMATION ON PENNY STOCKS**

**This statement is required by the U.S. Securities and Exchange Commission (SEC) and contains important information on penny stocks. You are urged to read it before making a purchase or sale.**

### **Penny stocks can be very risky.**

- Penny stocks are low-priced shares of small companies not traded on an exchange or quoted on NASDAQ. Prices often are not available. Investors in penny stocks often are unable to sell stock back to the dealer that sold them the stock. Thus, you may lose your investment. Be cautious of newly issued penny stock.
- Your salesperson is not an impartial advisor but is paid to sell you the stock. Do not rely only on the salesperson, but seek outside advice before you buy any stock. If you have problems with a salespersons, contact the firm's compliance officer or the regulators listed below.

### **Information you should get.**

- **Before you buy penny stock**, [effective January 1, 1993] federal law requires your salesperson to tell you the "**offer**" and the "**bid**" on the stock, and the "**compensation**" the salesperson and the firm receive for the trade. The firm also must mail a confirmation of these prices to you after the trade.
- You will need this price information to determine what profit, if any, you will have when you sell your stock. The offer price is the wholesale price at which the dealer is willing to sell stock to other dealers. The bid price is the wholesale price at which the dealer is willing to buy the stock from other dealers. In its trade with you, the dealer may add a retail charge to these wholesale prices as compensation (called a "markup" or "mark-down").
- The difference between the bid and the offer price is the dealer's "**spread**." A spread that is large compared with the purchase price can make a resale of a stock very costly. To be profitable when you sell, the bid price of your stock must rise above the amount of this spread **and** the compensation charged by both your selling and purchasing dealers. If the dealer has no bid price, you may not be able to sell the stock after you buy it, and may lose your whole investment.

### **Brokers' duties and customer rights and remedies.**

- If you are a victim of fraud, you may have rights and remedies under state and federal law. You can get the disciplinary history of a salesperson or firm from the NASD at 1-800-289- 9999, and additional information from your state securities official, at the North American Securities Administrators Association's central number: (202) 737-0900. You also may contact the SEC with complaints at (202) 272-7440.

## FURTHER INFORMATION

**THE SECURITIES BEING SOLD TO YOU HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION. MOREOVER, THE SECURITIES AND EXCHANGE COMMISSION HAS NOT PASSED UPON THE FAIRNESS OR THE MERITS OF THIS TRANSACTION NOR UPON THE ACCURACY OR ADEQUACY OF THE INFORMATION CONTAINED IN ANY PROSPECTUS OR ANY OTHER INFORMATION PROVIDED BY AN ISSUER OR A BROKER OR DEALER.**

Generally, penny stock is a security that:

- Is priced under five dollars;
- Is not traded on a national stock exchange or on NASDAQ (the NASD's automated quotation system for actively traded stocks);
- May be listed in the "pink sheets" or the NASD OTC Bulletin Board;
- Is issued by a company that has less than \$5 million in net tangible assets and has been in business less than three years, by a company that has under \$2 million in net tangible assets and has been in business for at least three years, or by a company that has revenues of \$6 million for 3 years.

### **Use caution when investing in penny stocks:**

**1. Do not make a hurried investment decision.** High-pressure sales techniques can be a warning sign of fraud. The salesperson is not an impartial advisor, but is paid for selling stock to you. The salesperson also does not have to watch your investment for you. Thus, you should think over the offer and seek outside advice. Check to see if the information given by the salesperson differs from other information you may have. Also, it is illegal for salespersons to promise that a stock will increase in value or is risk free, or to guarantee against loss. If you think there is a problem, ask to speak with a compliance official at the firm, and, if necessary, any of the regulators referred to in this statement.

**2. Study the company issuing the stock.** Be wary of companies that have no operating history, few assets, or no defined business purpose. These may be sham or "shell" corporations. Read the prospectus for the company carefully before you invest. Some dealers fraudulently solicit investors' money to buy stock in sham companies, artificially inflate the stock prices, then cash in their profits before public investors can sell their stock.

**3. Understand the risky nature of these stocks.** You should be aware that you may lose part or all of your investment. Because of large dealer spreads, you will not be able to sell the stock immediately back to the dealer at the same price it sold the stock to you. In some cases, the stock may fall quickly in value. New companies, whose stock is sold in an "initial public offering," often are riskier investments. Try to find out if the shares the salesperson wants to sell you are part of such an offering. Your salesperson must give you a "prospectus" in an initial public offering, but the financial condition shown in the prospectus of new companies can change very quickly.

**4. Know the brokerage firm and the salesperson with whom you are dealing.** Because of the nature of the market for penny stock, you may have to rely solely on the original brokerage firm that sold you the stock for prices and to buy the stock back from you. Ask the National Association of Securities Dealers, Inc. (NASD) or your state securities regulator, which is a member of the North American Securities Administrators Associations, Inc. (NASAA), about the licensing and disciplinary record of the brokerage firm and the salesperson contacting you. The telephone numbers of the NASD and NASAA are listed on the first page of this document.

**5. Be cautious if your salesperson leaves the firm.** If the salesperson who sold you the stock leaves his or her firm, the firm may reassign your account to a new salesperson. If you have problems, ask to speak to the firm's branch office manager or a compliance officer. Although the departing salesperson may ask you to transfer your stock to his or her new firm, you do not have to do so. Get information on the new firm. Be wary of requests to sell your securities when the salesperson transfers to a new firm. Also you have the right to get your stock certificate from your selling firm. You do not have to leave the certificate with that firm or any other firm.

## YOUR RIGHTS

**Disclosures to you.** Under penalty of federal law, [effective January 1, 1993] your brokerage firm must tell you the following information at two different times -- **before** you agree to buy or sell a penny stock, and after the trade, by **written confirmation.**

- **The bid and offer price quotes for penny stock and the number of shares to which the quoted prices apply.** The **bid** and **offer** quotes are the wholesale prices at which dealers trade among themselves. These prices give you an idea of the market value of the stock. The dealer must tell you these price quotes if they appear on an automated quotation system approved by the SEC. If not, the dealer must use its own quotes or trade prices. You should calculate the **spread**, the difference between the bid and offer quotes, to help decide if buying the stock is a good investment.

A lack of quotes may mean that the market among dealers is not active. It thus may be difficult to resell the stock. You also should be aware that the actual price charged to you for the stock may differ from the price quoted to you for 100 shares. You should therefore determine, before you agree to a purchase, what the actual sales price (before the **markup**) will be for the exact number of shares you want to buy.

- **The brokerage firm's compensation for the trade.** A **markup** is the amount a dealer adds to the wholesale offer price of the stock and a **markdown** is the amount it subtracts from the wholesale bid price of the stock as **compensation.** A markup/markdown usually serves the same role as a broker's commission on a trade. Most of the firms in the penny stock market will be dealers, not brokers.

- **The compensation received by the brokerage firm's salesperson for the trade.** The brokerage firm must disclose to you, as a total sum, the cash compensation of your salesperson for the trade that is known at the time of the trade. The firm must describe in the written confirmation the nature of any other compensation of your salesperson that is unknown at the time of the trade.

In addition to the items listed above, your brokerage firm must send to you:

- **Monthly account statements.** In general, [effective January 1, 1993] your **brokerage firm must send you a monthly statement** that gives an estimate of the value of each penny stock in your account, if there is enough information to make an estimate. If the firm has not bought or sold any penny stocks for your account for six months, it can provide these statements every three months.

- **A Written Statement of Your Financial Situation and Investment Goals.** In general, unless you have had an account with your brokerage firm for more than one year, or you have previously bought three different penny stocks from the firm, your brokerage firm must send you a written statement for you to sign that accurately describes your financial situation, your investment experience, and your investment goals, and that contains a statement of why your firm decided that penny stocks are a suitable investment for you. The firm also must get your written consent to buy the penny stock.

**Legal remedies.** If penny stocks are sold to you in violation of your rights listed above, or other federal or state securities laws, you may be able to cancel your purchase and get your money back. If the stocks are sold in a fraudulent manner, you may be able to sue the persons and firms that caused the fraud for damages. If you have signed an arbitration agreement, however, you may have to pursue your claim through arbitration. You may wish to contact an attorney. The SEC is not authorized to represent individuals in private litigation.

However, to protect yourself and other investors, you should report any violations of your brokerage firms' duties listed above and other securities laws to the SEC, the NASD, or your state securities administrator at the telephone numbers on the first page of this document. These bodies have the power to stop fraudulent and abusive activity of salespersons and firms engaged in the securities business. Or you can write to the SEC at 450 Fifth St., N.W., Washington, D.C. 20549; the NASD at 1735 K Street, N.W., Washington, D.C. 20006; or NASAA at 555 New Jersey Avenue, N.W., Suite 750, Washington, D.C. 20001. NASAA will give you the telephone number of your state's securities agency. If there is any disciplinary record of a person or firm, the NASD, NASAA, or your state securities regulator will send you this information if you ask for it.

## MARKET INFORMATION

**The market for penny stocks.** Penny stocks usually are not listed on an exchange or quoted on the NASDAQ system. Instead, they are traded between dealers on the telephone in the “over-the-counter” market. The NASD’s OTC Bulletin Board also will contain information on some penny stocks. At times, however, price information for these stocks is not publicly available.

**Market domination.** In some cases, only one or two dealers, acting as “market makers,” may be buying and selling a given stock. You should first ask if a firm is acting as a **broker** (your agent) or as a dealer. A **dealer** buys stock itself to fill your order or already owns the stock. A **market maker** is a dealer who holds itself out as ready to buy and sell stock on a regular basis. If the firm is a market maker, ask how many other market makers are dealing in the stock to see if the firm (or group of firms) dominates the market. When there are only one or two market makers, there is a risk that the dealer or group of dealers may control the market in that stock and set prices that are not based on competitive forces. In recent years, some market makers have created fraudulent markets in certain penny stocks, so that stock prices rose suddenly, but collapsed just as quickly, at a loss to investors.

**Mark-ups and mark-downs.** The actual price that the customer pays usually includes the mark-up or mark-down. Markups and markdowns are direct profits for the firm and its salespeople, so you should be aware of such amounts to assess the overall value of the trade.

**The “spread.”** The difference between the bid and offer price is the spread. Like a mark-up or mark-down, the spread is another source of profit for the brokerage firm and compensates the firm for the risk of owning the stock. A large spread can make a trade very expensive to an investor. For some penny stocks, the spread between the bid and the offer price may be a large part of the purchase price of the stock. Where the bid price is much lower than the offer price, the market value of the stock must rise substantially before the stock can be sold at a profit. Moreover, an investor may experience substantial losses if the stock must be sold immediately.

**Example:** If the bid is \$0.04 per share and the offer is \$0.10 per share, the spread (difference) is \$0.06, which appears to be a small amount. But you would lose \$0.06 on every share that you bought for \$0.10 if you had to sell that stock immediately to the same firm. If you had invested \$5,000 at the \$0.10 offer price, the market maker’s repurchase price, at \$0.04 bid, would be only \$2,000; thus would lose \$3,000, or more than half of your investment, if you decided to sell the stock. In addition, you would have to pay compensation (a “mark-up,” “mark-down” or commission) to buy and sell the stock.

**In addition to the amount of the spread,** the price of your stock must rise enough to make up for the compensation that the dealer charged you when it first sold you the stock. Then, when you want to resell the stock, a dealer again will charge compensation, in the form of a markdown. The dealer subtracts the markdown from the price of the stock when it buys the stock from you. Thus, to make profit, the bid price of your stock must rise above the amount of the original spread, the markup, and the markdown.

**Primary offerings.** Most penny stocks are sold to the public on an ongoing basis. However, dealers sometimes sell these stocks in initial public offerings. You should pay special attention to stocks

of companies that have never been offered to the public before, because the market for these stocks is untested. Because the offering is on a first-time basis, there is generally no market information about the stock to help determine its value. The federal securities laws generally require broker-dealers to give investors a “prospectus,” which contains information about the objectives, management, and financial condition of the issuer. In the absence of market information, investors should read the company’s prospectus with special care to find out if the stocks are a good investment. However, the prospectus is only a description of the current condition of the company. The outlook of the start-up companies described in a prospectus often is very uncertain.

**For more information about penny stocks,** contact the Office of Filings, Information, and Consumer Services of the U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549, (202) 272-7440.



## **REQUIREMENTS FOR TRANSACTIONS IN PENNY STOCKS**

### **A. Background**

In 1989, the SEC adopted Rule 15c2-6 under the 1934 Act. Referred to as the “Cold Calling Rule”, Rule 15c2-6 was intended to prevent the use of fraudulent, high pressure telephone sales campaigns to sell low price securities to unsophisticated investors. In 1990, Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (“Penny Stock Reform Act”), which mandated that the SEC adopt rules requiring brokers to provide customers with certain trade and market information prior to effecting a transaction in a penny stock. Pursuant to the authority given to it in the Penny Stock Reform Act, the SEC amended Rule 15c2-6, redesignated it as Rule 15g-9, and adopted several other rules which are meant to assist in the prevention of fraud in the sale of low-priced/over-the-counter securities (“penny stocks”).

### **B. Definition of Penny Stock** (Rule 3a51-1)

A “penny stock” is defined as any equity security not in one of the categories specifically excluded by Section 3(a)(51)(A) of the 1934 Act or SEC Rule 3a51-1. The following categories are excluded from being designated as penny stocks:

The security is registered, or approved for registration upon notice of issuance, on a national securities exchange that has been continuously registered as a national securities exchange since April 20, 1992 (the date of the adoption of Rule 3a51-1 (§ 240.3a51-1) by the Commission); and the national securities exchange has maintained quantitative listing standards that are substantially similar to or stricter than those listing standards that were in place on that exchange on January 8, 2004; or

(2) The security is registered, or approved for registration upon notice of issuance, on a national securities exchange, or is listed, or approved for listing upon notice of issuance on, an automated quotation system sponsored by a registered national securities association, that:

(i) Has established initial listing standards that meet or exceed the following criteria:

(A) The issuer shall have:

(1) Stockholders' equity of \$5,000,000;

(2) Market value of listed securities of \$50 million for 90 consecutive days prior to applying for the listing (market value means the closing bid price multiplied by the number of securities listed); or

(3) Net income of \$750,000 (excluding non-recurring items) in the most recently completed fiscal year or in two of the last three most recently completed fiscal years;

(B) The issuer shall have an operating history of at least one year or a market value of listed securities of \$50 million (market value means the closing bid price multiplied by the number of securities listed);

(C) The issuer's stock, common or preferred, shall have a minimum bid price of \$4 per share;

(D) In the case of common stock, there shall be at least 300 round lot holders of the security (a round lot holder means a holder of a normal unit of trading);

(E) In the case of common stock, there shall be at least 1,000,000 publicly held shares and such shares shall have a market value of at least \$5 million (market value means the closing bid price multiplied by number of publicly held shares, and shares held directly or

indirectly by an officer or director of the issuer and by any person who is the beneficial owner of more than 10 percent of the total shares outstanding are not considered to be publicly held);

(F) In the case of a convertible debt security, there shall be a principal amount outstanding of at least \$10 million;

(G) In the case of rights and warrants, there shall be at least 100,000 issued and the underlying security shall be registered on a national securities exchange or listed on an automated quotation system sponsored by a registered national securities association and shall satisfy the requirements of paragraph (a) or (e) of this section;

(H) In the case of put warrants (that is, instruments that grant the holder the right to sell to the issuing company a specified number of shares of the company's common stock, at a specified price until a specified period of time), there shall be at least 100,000 issued and the underlying security shall be registered on a national securities exchange or listed on an automated quotation system sponsored by a registered national securities association and shall satisfy the requirements of paragraph (a) or (e) of this section;

(I) In the case of units (that is, two or more securities traded together), all component parts shall be registered on a national securities exchange or listed on an automated quotation system sponsored by a registered national securities association and shall satisfy the requirements of paragraph (a) or (e) of this section; and

(J) In the case of equity securities (other than common and preferred stock, convertible debt securities, rights and warrants, put warrants, or units), including hybrid products and derivative securities products, the national securities exchange or registered national securities association shall establish quantitative listing standards that are substantially similar to those found in paragraphs (a)(2)(i)(A) through (a)(2)(i)(I) of this section; and

(ii) Has established quantitative continued listing standards that are reasonably related to the initial listing standards set forth in paragraph (a)(2)(i) of this section, and that are consistent with the maintenance of fair and orderly markets;

(b) That is issued by an investment company registered under the Investment Company Act of 1940;

(c) That is a put or call option issued by the Options Clearing Corporation;

(d) Except for purposes of section 7(b) of the Securities Act and Rule 419 that has a price of five dollars or more\*;

(1) For purposes of paragraph (d) of this section:

(i) A security has a price of five dollars or more for a particular transaction if the security is purchased or sold in that transaction at a price of five dollars or more, excluding any broker or dealer commission, commission equivalent, mark-up, or mark-down; and

(ii) Other than in connection with a particular transaction, a security has a price of five dollars or more at a given time if the inside bid quotation is five dollars or more; *provided, however,* that if there is no such inside bid quotation, a security has a price of five dollars or more at a given time if the average of three or more interdealer bid quotations at specified prices displayed at that time in an interdealer quotation system, as defined in 17 CFR 240.15c2-7(c)(1), by three or more market makers in the security, is five dollars or more.

(iii) The term "inside bid quotation" shall mean the highest bid quotation for the security displayed by a market maker in the security on 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, 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.

(2) If a security is a unit composed of one or more securities, the unit price divided

by the number of shares of the unit that are not warrants, options, rights, or similar securities must be five dollars or more, as determined in accordance with paragraph (d)(1) of this section, and any share of the unit that is a warrant, option, right, or similar security, or a convertible security, must have an exercise price or conversion price of five dollars or more;

(e)

(1) That is registered, or approved for registration upon notice of issuance, on a national securities exchange that makes transaction reports available pursuant to § 242.601, provided that:

(i) Price and volume information with respect to transactions in that security is required to be reported on a current and continuing basis and is made available to vendors of market information pursuant to the rules of the national securities exchange;

(ii) The security is purchased or sold in a transaction that is effected on or through the facilities of the national securities exchange, or that is part of the distribution of the security; and

(iii) The security satisfies the requirements of paragraph (a)(1) or (a)(2) of this section;

(2) A security that satisfies the requirements of this paragraph (e), but does not otherwise satisfy the requirements of paragraph (a), (b), (c), (d), (f), or (g) of this section, shall be a penny stock for purposes of section 15(b)(6) of the Act (15 U.S.C. 78o(b)(6));

(f) That is a security futures product listed on a national securities exchange or an automated quotation system sponsored by a registered national securities association; or

(g) Whose issuer has:

(1) Net tangible assets (i.e., total assets less intangible assets and liabilities) in excess of \$2,000,000, if the issuer has been in continuous operation for at least three years, or \$5,000,000, if the issuer has been in continuous operation for less than three years; or

(2) Average revenue of at least \$6,000,000 for the last three years.

(3) For purposes of paragraph (g) of this section, net tangible assets or average revenues must be demonstrated by financial statements dated less than fifteen months prior to the date of the transaction that the broker or dealer has reviewed and has a reasonable basis for believing are accurate in relation to the date of the transaction, and:

(i) If the issuer is other than a foreign private issuer, are the most recent financial statements for the issuer that have been audited and reported on by an independent public accountant in accordance with the provisions of 17 CFR 210.2-02; or

(ii) If the issuer is a foreign private issuer, are the most recent financial statements for the issuer that have been filed with the Commission or furnished to the Commission pursuant to 17 CFR 240.12g3-2(b); *provided, however*, that if financial statements for the issuer dated less than fifteen months prior to the date of the transaction have not been filed with or furnished to the Commission, financial statements dated within fifteen months prior to the transaction shall be prepared in accordance with generally accepted accounting principles in the country of incorporation, audited in compliance with the requirements of that jurisdiction, and reported on by an accountant duly registered and in good standing in accordance with the regulations of that jurisdiction.

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\* In most cases the price of the security will be determined by the price at which a security is purchased or sold in a particular transaction, excluding any commission, markup or markdown.

**C. Transactional Exemptions (Rule 15g-1)**

Besides creating classes of securities that are not subject to the penny stock reporting and disclosure requirements, the SEC has created exemptions from the requirements in Rules 15g-2 through 15g-6 and Rule 15g-9 for certain transactions in securities which normally would qualify as penny stocks. The following transactions are exempt from Rules 15g-2 through 15g-6 and Rule 15g-9:

Transactions by a broker or dealer:

(1) Whose commissions, commission equivalents, mark-ups, and mark-downs from transactions in penny stocks during each of the immediately preceding three months and during eleven or more of the preceding twelve months, or during the immediately preceding six months, did not exceed five percent of its total commissions, commission equivalents, mark-ups, and mark-downs from transactions in securities during those months; and

(2) Who has not been a market maker in the penny stock that is the subject of the transaction in the immediately preceding twelve months.

**Note:**

Prior to April 28, 1993, commissions, commission equivalents, mark-ups, and mark-downs from transactions in designated securities, as defined as of April 15, 1992, may be considered to be commissions, commission equivalents, mark-ups, and mark-downs from transactions in penny stocks for purposes of paragraph (a)(1) of this section.

(b) Transactions in which the customer is an institutional accredited investor

**Note 1 to paragraph (b):**

Though the definition of “family client” from rule 501(a)(13) includes both natural persons and institutions, only family clients that are institutions may be considered institutional accredited investors.

(c) Transactions that meet the requirements of Regulation D or transactions with an issuer not involving any public offering pursuant to section 4(a)(2) of the Securities Act of 1933.\*\*

(d) Transactions in which the customer is the issuer, or a director, officer, general partner, or direct or indirect beneficial owner of more than five percent of any class of equity security of the issuer, of the penny stock that is the subject of the transaction.

(e) Transactions that are not recommended by the broker or dealer\*\*\*.

(f) Any other transaction or class of transactions or persons or class of persons that, upon prior written request or upon its own motion, the Commission conditionally or unconditionally exempts by order as consistent with the public interest and the protection of investors.

**D. Schedule 15G Risk Disclosure Document (Rule 15g-2)**

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, prior to effecting such transaction, the broker or dealer has furnished to the customer a document containing the information set forth in Schedule 15G, and has obtained from the customer a signed and dated acknowledgment of receipt of the document.

(b) Regardless of the form of acknowledgment used to satisfy the requirements of paragraph (a) of this section, 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 less than two business days after the broker or dealer sends such document.

**(c)** The broker or dealer shall preserve, as part of its records, a copy of the written acknowledgment required by paragraph (a) of this section for the period specified in paragraph (b) of this chapter

**(d)** Upon request of the customer, the broker or dealer shall furnish the customer with a copy of the penny stock disclosure document.

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\*\* regulation D offerings under Rule 504, 505, and 506 are exempt from Rules 15g-1 through 15g-6. Offerings under Rules 505 and 506 are exempt from Rule 15g-9, while offerings under Rule 504 must comply with Rule 15g-9.

\*\*\* Transactions not recommended by the broker dealer is a broader term than unsolicited transactions, and thus unsolicited can still be subject to the penny stock disclosure requirements.

**E. Disclosure of Quotations and Other Information Relating to the Penny Stock Market (Rule 15g-3)**

(a) *Requirement.* It shall be unlawful for a broker or dealer to effect a transaction in any penny stock with or for the account of a customer unless such broker or dealer discloses to such customer, within the time periods and in the manner required by paragraph (b) of this section, the following information:

(1) The inside bid quotation and the inside offer quotation for the penny stock.

(2) If paragraph (a)(1) of this section does not apply because of the absence of an inside bid quotation and an inside offer quotation:

(i) With respect to a transaction effected with or for a customer on a principal basis (other than as provided in paragraph (a)(2)(ii) of this section):

(A) The dealer shall disclose its offer price for the security:

(1) If during the previous five days the dealer has effected no fewer than three *bona fide* sales to other dealers consistently at its offer price for the security current at the time of those sales, and

(2) If the dealer reasonably believes in good faith at the time of the transaction with the customer that its offer price accurately reflects the price at which it is willing to sell one or more round lots to another dealer. For purposes of paragraph (a)(2)(i)(A) of this section, “consistently” shall constitute, at a minimum, seventy-five percent of the dealer's *bona fide* interdealer sales during the previous five-day period, and, if the dealer has effected only three *bona fide* inter-dealer sales during such period, all three of such sales.

(B) The dealer shall disclose its bid price for the security:

(1) If during the previous five days the dealer has effected no fewer than three *bona fide* purchases from other dealers consistently at its bid price for the security current at the time of those purchases, and

(2) If the dealer reasonably believes in good faith at the time of the transaction with the customer that its bid price accurately reflects the price at which it is willing to buy one or more round lots from another dealer. For purposes of paragraph (a)(2)(i)(B) of this section, “consistently” shall constitute, at a minimum, seventy-five percent of the dealer's *bona fide* interdealer purchases during the previous five-day period, and, if the dealer has effected only three *bona fide* inter-dealer purchases during such period, all three of such purchases.

(C) If the dealer's bid or offer prices to the customer do not satisfy the criteria of paragraphs (a)(2)(i)(A) or (a)(2)(i)(B) of this section, the dealer shall disclose to the customer:

(1) That it has not effected inter-dealer purchases or sales of the penny stock consistently at its bid or offer price, and

(2) The price at which it last purchased the penny stock from, or sold the penny stock to, respectively, another dealer in a *bona fide* transaction.

(ii) With respect to transactions effected by a broker or dealer with or for the account of the customer:

(A) On an agency basis or

(B) On a basis other than as a market maker in the security, where, after having received an order from the customer to purchase a penny stock, the dealer effects the purchase from another person to offset a contemporaneous sale of the penny stock to such customer, or, after having received an order from the customer to sell the penny stock, the dealer effects the sale to another person to offset a

contemporaneous purchase from such customer, the broker or dealer shall disclose the best independent interdealer bid and offer prices for the penny stock that the broker or dealer obtains through reasonable diligence. A broker-dealer shall be deemed to have exercised reasonable diligence if it obtains quotations from three market makers in the security (or all known market makers if there are fewer than three).

(3) With respect to bid or offer prices and transaction prices disclosed pursuant to paragraph (a) of this section, the broker or dealer shall disclose the number of shares to which the bid and offer prices apply.

(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.

(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.

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

(1) The term *bid price* shall mean the price most recently communicated by the dealer to another broker or dealer at which the dealer is willing to purchase one or more round lots of the penny stock, and shall not include indications of interest.

(2) The term *offer price* shall mean the price most recently communicated by the dealer to another broker or dealer at which the dealer is willing to sell one or more round lots of the penny stock, and shall not include indications of interest.

(3) The term *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.

(4) The term *inside offer quotation* for a security shall mean the lowest offer 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.

(5) 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.

**F. Disclosure to Customers of Compensation Earned by the Broker-Dealer and Salesperson** (Rule 15g-4 and 15g-5)

**a) *Disclosure requirement.*** It shall be unlawful for any broker or dealer to effect a transaction in any penny stock for or with the account of a customer unless such 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 any compensation received by such broker or dealer in connection with such transaction.

**(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.

**(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.

**(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 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.

**(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.

(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 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.

**G. Account Statements for Penny Stocks** (Rule 15g-6)

A broker-dealer that has sold penny stocks to a customer must furnish a monthly account statement to the customers (unless one of the exemptions in the rule applies) which discloses the identity and total number of shares of each penny stock held in the customer's account and the estimated market value of those securities. In addition, the statement must contain a conspicuous legend that is identified with the penny stocks listed in the statement 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 TO 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 RECEIVED 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.

## **H.     The Cold Calling Rule**

Many securities firms telephone investors they do not know to sell stocks and other investments. These "cold calls" can serve as a legitimate way of reaching new customers, but they can also lead to trouble. Dishonest brokers may pressure you to buy a bad investment or a scam. Whether the calls are annoying, abusive, or downright crooked, you can stop cold callers. The law protects you by requiring cold callers to follow several rules:

- Cold callers may only call you at home between 8:00 a.m. and 9:00 p.m. These time restrictions do not apply if you are already a customer of the firm or you've given the firm permission to call you at other times. Cold callers may call you at work at any time.
- Cold callers must say who's calling and why. Cold callers must promptly tell you their name, their firm's name, address or telephone number and that the purpose of the call is to sell you an investment.
- Cold callers must put you on their "Do Not Call" list, if you ask. Every securities firm must keep a "Do Not Call" list. If you want to stop sales calls from that firm, tell the caller to put your name and telephone number on the firm's "Do Not Call" list. If anyone from that firm calls you again, get the caller's name and telephone number, note the date and time of the call, and complain to the firm's compliance officer, the SEC, and your state's securities regulator.
- Cold Caller must avoid calls to you if you are on the National "Do Not Call" Registry managed by the Federal Trade Commission. If you want to sign up, go to <https://www.donotcall.gov/>. Cold callers cannot call you if you are on this registry, unless you are already a customer, you previously gave written permission, or the caller is a family member, friend, or acquaintance. However, even if any of those exceptions applies, you can still stop calls by asking the caller to put your name and telephone number on the firm's "Do Not Call" list. The FTC also accepts online complaints about unwanted calls from those on the National "Do Not Call" registry.
- Cold callers must get your written approval before taking money directly from your bank accounts. Before investing, you should always get answers to your questions and written information about the investment. If you decide to buy from a cold caller, do not give your checking or savings account numbers to the broker over the phone. Brokers must get your written permission - such as your signature on a check or an authorization form - before they can take money from your checking or savings account.
- Cold callers must tell you the truth. People selling securities must tell you the truth. Brokers who lie to you about any important aspect of an investment opportunity violate federal and state securities laws.

## **1. Prior Account Approval by Broker-Dealer**

Prior to effecting a penny stock transaction, the broker-dealer must have approved the person's account for transactions in penny stocks. In order to approve a persons' account for transactions in penny stocks the broker-dealer must:

- (a) obtain from the person information concerning the person's financial situation; investment experience and investment objectives;
- (b) reasonably determine, based on such information, that transactions in penny stocks are suitable for the person and that the person has sufficient knowledge and experience in financial, matters that the person may be expected to be a capable of evaluating the risks of transactions in penny stocks;
- (c) deliver to the person a written statement setting forth the basis on which the suitability, knowledge and experience determinations were made by the broker-dealer, stating in a highlighted format that it is unlawful for the broker-dealer to effect a transaction in a penny stock unless the broker-dealer has received, prior to the transaction, a written agreement to the transaction from the person; and stating in a highlighted format immediately preceding the customer signature line that the broker-dealer is required to provide the person with the written statement, and that the person should not sign and return the written statement if it does not accurately reflect the person's financial situation, investment experience, and investment objectives;
- (d) obtain from the person a manually signed and dated copy of the written statement described above.

A Rule 15g-9 Customer Suitability Statement is included at the end of this section.

## **2. Written Customer Agreement to Penny Stock Transaction**

Prior to the transaction, the broker-dealer also must receive from the person a written agreement stating the identity and quantity of the penny stock to be purchased.

