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 cause use of the mails or of any means or instrumentalities 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) other than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purpose of this section, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

"(2) No broker or dealer shall cause use of the mails or of any means or instrumentalities of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than a governmental security or commercial paper, bankers' acceptances, or commercial bills) other 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 false or fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably de-
REGULATION OF OVER-THE-COUNTER MARKETS

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

"(3) No broker or dealer shall make use of the mails or of any means or instrumentalities 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) other than upon 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 to 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 (6) 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 government 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 important, the activities embraced therein are varied, and they are of the utmost importance to the national economy.
REGULATION OF OVER-THE-COUNTER MARKETS

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 1,375 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 $1,269,000,000 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.

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.
Similarly, the report of the House Committee on Interstate and Foreign Commerce (H. Rept. No. 1385, 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, 10 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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This program of cooperation, in which the task will be largely

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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 contem-

plated 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 purpose here-

above discussed. As a result of the activities of the conference

committee, there came into existence in 1935 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 organiza-
tion 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 applica-
tion 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 require-
ments which an association of brokers or dealers must satisfy to qualify
for the registration as a national securities association. The require-
ments are enumerated in 10 paragraphs, a discussion of which follows:

(a) Paragraph (1) of subsection (b). This paragraph limits eligi-
bility for registration as a national securities association to such asso-
ciations as are a proper subject of national concern. It is contem-
plated that associations, to qualify under this paragraph, should
either be actually Nation-wide in scope or should represent a substan-
tial 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 eligi-
bility for registration as a national securities association to associations
of which the general pattern of organization and general character or
such as to satisfy the Commission that they will be able effectively 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
REGULATION OF OVER-THE-COUNTER MARKETS

Section 15A of the Securities Exchange Act of 1934, as amended, provides a basis for the formation of associations and the registration of certain specified securities, as well as for the registration of brokers and dealers in such securities association. 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 of the Commission in cases in which the Commission finds it appropriate in the public interest 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 or 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, was a cause which contributed to any suspension, expulsion, or order of the character described above which is in effect in the public interest in the public interest.

Section 15A of the Securities Exchange Act of 1934, as amended, provides for the registration of certain specified securities, as well as for the registration of brokers and dealers in such securities association. The broad purpose of this paragraph is to assure to each member of a registered securities association reasonable representation in all phases of its operations.

Membership, the committee is informed, of all parts of the United States. There are a number of other associations of whose some time examined a degree of their membership. It is a purpose of this bill to provide a sound and practical basis for the registration of certain specified securities, as well as for the registration of brokers and dealers in such securities association.
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, 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 (9) 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 (10) 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 15A.—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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4. Subsection (b) 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 registra-
tion 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, automatic-
ment 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. THE NO-REASON ABSENCE 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 EXCLUSION 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 au-
thesize an association by its rules to prescribe any uniform differences
between prices charged or discounts allowed to brokers and dealers,
or between members of the public, on the one hand, and non-
members of the association, on the other hand, to which members of the association must adhere. Any such rule would
be in derogation of paragraph (j) of subsection (h). The individual
member is left free to determine his own business policy, but, insofar
as he differentiates in prices, discounts, and other charges or allow-
ances 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 (i) of section 15A.—This subsection requires regis-
tered 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 supple-
ment the original registration statement and documents filed there-
with, 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

11. REP. 2097, 73-3.—2
addition appears to the Commission to be consistent with the require-
ments of subsection (b) and subsection (c).

11. Subsection (k) of section 15A.—Under this subsection, the Com-
mision 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 appro-
priate 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 Com-
mision 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 se-
curities association. These supervisory powers are designed to pre-
vent abuse, and to enable the Commission effectively 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 trans-
actions 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 pro-
vision 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 subsec-
tion (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 Com-
mision has adopted rules and regulations which have withstood the
tests 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).
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 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. 12. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentalities 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 paper otherwise than as 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 and within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer 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 and 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) of such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made 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, which application or document was false or misleading in any material respect, or (B) 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, 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
OVER-THE-COUNTER MARKETS

Black brackets, new matter is printed in red, change is proposed is shown in roman.

On either of the securities or commercial paper, bankers' acceptance or 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' acceptance, 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.

Nothing in clause (3), (4), or (5) of this subsection shall be construed to affect the time and method of making settlements, payments, or deliveries provided, that nothing in clause (4), (5), or (6) of this subsection shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

Section 12(a) of the Act of 1934, as amended, shall contain an undertaking by the issuer of the issue of securities to which the registration statement relates to file such supplementary and periodic information, documents, and reports as may be necessary or appropriate in the public interest or for the protection of investors, and such undertaking shall be performed by such issuer or by any person controlling such issuer, or by the successor of such issuer, as the Commission may determine.

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Nothing in clause (3), (4), or (5) of this subsection shall be construed to affect the time and method of making settlements, payments, or deliveries provided, that nothing in clause (4), (5), or (6) of this subsection shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.
as necessary or appropriate in the public interest or for the protection of investors; and

(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the "rules of the association."

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section;

(2) such association is organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section;

(3) the rules of the association provide that 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, may become a member of such association, except such as are excluded pursuant to paragraph (2) of this subsection; Provided, That the rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its 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 purpose of this section;

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest to so do, no broker or dealer shall be admitted to or continued in membership in such association, if (1) such broker or dealer, whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer, was a cause of any suspension, expulsion, or order of the Commission denying or revoking his registration pursuant to section 15 of this title, or (3) the character described in clause (A) or (B) of section 15 of this title has been and is suspended or expelled from a registered securities association (whether national or affiliated) or a national securities exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act inconsistent with just and equitable principles of trade, or (B) is subject to an order of the Commission denying or revoking his registration pursuant to section 15 of this title, or (3) the character described in clause (A) or (B) which is in effect with respect to such broker or dealer;

(5) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the election of its officers and directors, and in all other phases of the administration of its affairs;

(6) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration;

(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impracticable and unjust discrimination between customers, or issuers, or brokers or dealers, in the size of commissions, or charges, or discounts, or other charges;

(8) the rules of the association provide that its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules;
The rules of the association provide for the equitable allocation of any suspension, expulsion, or order of the Commission based on the specific grounds, and in the manner and under the terms and conditions provided by the rules of such national securities association in accordance with subsection (c). The Commission shall fail to admit promptly thereafter to affiliation with a registered national securities association or any affiliated securities association in any way limited by reason of any such affiliation.

(4) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that:

(i) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (d), will, with such powers and responsibilities as to such affiliation, and under such other appropriate terms and conditions, be admitted to affiliation with a registered national securities association pursuant to subsection (d), in the manner and under the terms and conditions provided by the rules of such national securities association in accordance with subsection (c); and

(ii) such association and its rules satisfy the requirements set forth in paragraphs (3) to (6), inclusive, of subsection (d), except that in the case of any such association, any restrictions upon membership therein of the nature described by paragraph (c) of subsection (d) shall not be less stringent than in the case of the national securities association with which such association is affiliated.

(5) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall revoke the registration of such affiliated securities association.

(6) A registered securities association (either national or affiliated) may, upon such reasonable notice as the Commission may deem necessary in the public interest or for the protection of investors withdraw from registration by filing with the Commission a notice of withdrawal in such form and manner as the Commission shall by rule or regulations prescribe, but such withdrawal shall be subject to such appropriate terms and conditions for the orderly liquidation of such association as the Commission may prescribe. Upon the withdrawal of a national securities association or upon the withdrawal of an affiliated securities association the registration of any association affiliated therewith shall automatically terminate.

(7) If any registered securities association (whether national or affiliated) shall take any disciplinary action against any member thereof, or shall deny admission to any broker or dealer seeking membership therein, such action shall be subject to review by the Commission on its own motion, or upon application by any person aggrieved within sixty days after such action has been taken or within...
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).

(h) (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, determines that such action was inconsistent with just and equitable principles of trade, it shall find that such action should not be modified or reversed 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 (1), or if the Commission shall determine that such 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, it shall find that such action should be modified or reversed 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 (2), or if the Commission shall determine that such 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, it shall find that such action should be modified or reversed in accordance with paragraph (2) of this subsection.

(2) 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 (a) 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.

(3) 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 instrumentalities of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any non-member security, 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.

(4) Nothing in this subsection shall be 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.

(5) 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 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 in force under the provisions of this title, unless permitted under the provisions of subsection (h) of this section. Any change in or addition to the rules of a registered securities association shall take effect upon the thirty-first 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 order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

((b) The Commission is authorized by order to adopt any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such adoption 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 to protect investors or 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
The matters hereinafter recited. 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 therefore requested of, 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 disciplinary action taken by a registered securities association; (2) the method for adoption of any change or addition to the rules of the association; (3) the method of choosing officers and directors; and (4) affiliation between registered securities associations.

(4) 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 ten days, or to suspend any person who, he had reason to believe, has violated any provision of this title or any rule or regulation thereunder, or who has affected any transaction for any other person who, he had reason to believe, has violated any provision of this title or any rule or regulation thereunder, or who has affected any transaction for any other person who, he had reason to believe, has violated any provision of this title or any rule or regulation thereunder.

(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 may be 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 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 inspection 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. 29. (a) Any condition, stipulation, or provision binding any person to violate compliance with any provision of this title or 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) 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. 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.

(e) 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.

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 $500 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.