

(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 offer 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 you 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. $\frac{1}{4}$

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 a 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, NW., Washington, DC 20549, (202) 272-7440.

[57 FR 18035, Apr. 28, 1992, as amended at 57 FR 31446, July 16, 1992; 58 FR 37417, July 12, 1993]

NATIONAL AND AFFILIATED SECURITIES ASSOCIATIONS

§ 240.15Aa-1 Registration of a national or an affiliated securities association.

Any application for registration of an association as a national, or as an affiliated, securities association shall be made in triplicate on Form X-15AA-1 accompanied by three copies of the exhibits prescribed by the Commission to be filed in connection therewith.

(Sec. 15A, 52 Stat. 1070; 15 U.S.C. 78o-3)

[13 FR 8209, Dec. 22, 1948. Redesignated at 30 FR 11851, Sept. 16, 1965]

§ 240.15Aj-1 Amendments and supplements to registration statements of securities associations.

Every association applying for registration or registered as a national securities association or as an affiliated securities association shall keep its registration statement up-to-date in the manner prescribed below:

Securities and Exchange Commission

§ 240.15Aj-1

(a) *Amendments.* Promptly after the discovery of any inaccuracy in the registration statement or in any amendment or supplement thereto the association shall file with the Commission an amendment correcting such inaccuracy.

(b) *Current supplements.* Promptly after any change which renders no longer accurate any information contained or incorporated in the registration statement or in any amendment or supplement thereto the association shall file with the Commission a current supplement setting forth such change, except that:

(1) Supplements setting forth changes in the information called for in Exhibit C need not be filed until 10 days after the calendar month in which the changes occur.

(2) No current supplements need be filed with respect to changes in the information called for in Exhibit B.

(3) If changes in the information called for in items (1) and (2) of Exhibit C are reported in any record which is published at least once a month by the association and promptly filed in triplicate with the Commission, no current supplement need be filed with respect thereto.

(c) *Annual supplements.* (1) Promptly after March 1 of each year, the association shall file with the Commission an annual consolidated supplement as of such date on Form X-15AJ-2 (§ 249.803) except that:

(i) If the securities association publishes or cooperates in the publication of the information required in Items 6(a) and 6(b) of Form X-15AJ-2 on an annual or more frequent basis, in lieu of filing such an item the securities association may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date.

(ii) Promptly after March 1, 1995, and every three years thereafter each association shall file complete Exhibit A to Form X-15AJ-2. The information contained in this exhibit shall be up to date as of the latest practicable date

within 3 months of the date on which these exhibits are filed. If the association publishes or cooperates in the publication of the information required in this exhibit on an annual or more frequent basis, in lieu of filing such exhibit the association may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date. If a securities association keeps the information required in this exhibit up to date and makes it available to the Commission and the public upon request, in lieu of filing such an exhibit a securities association may certify that the information is kept up to date and is available to the Commission and the public upon request.

(2) Promptly after the close of each fiscal year of the association, it shall file with the Commission a supplement setting forth its balance sheet as of the close of such year and its income and expense statement for such year.

(d) *Filing, dating, etc.* Each amendment or supplement shall be filed in triplicate, at least one of which must be signed and attested, in the same manner as required in the case of the original registration statement, and must conform to the requirements of Form X-15Aj-1, except that the annual consolidated supplement shall be filed on Form X-15Aj-2. All amendments and supplements shall be dated and numbered in order of filing. One amendment or supplement may include any number of changes. In addition to the formal filing of amendments and supplements above described, each association shall send to the Commission three copies of any notices, reports, circulars, loose-leaf insertions, riders, new additions, lists or other records of changes covered by amendments or supplements when, as and if such records are made available to members of the association.

(Sec. 15A, 52 Stat. 1070; 15 U.S.C. 78o-3)

[13 FR 8209, Dec. 22, 1948, as amended at 18 FR 6259, Oct. 1, 1953. Redesignated at 30 FR 11851, Sept. 16, 1965; 59 FR 66700, Dec. 28, 1994]