

17 CFR Part 240

[Release No. 22172; File No. S7-19-84]

Vol. 50 No. 151
Persons Deemed Not To Be Brokers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting Rule 3a4-1 specifying a non-exclusive safe harbor under which persons associated with an issuer of securities who participate in sales of that issuer's securities will not be considered to be acting as "brokers" as that term is defined in the Securities Exchange Act of 1934. Accordingly, these persons would not be required to register with the Commission pursuant to Section 15 of that Act. The Commission is adopting the Rule in order to provide guidance concerning the applicability of the

broker-dealer registration requirement in situations where an issuer chooses to sell its securities through its associated persons.

EFFECTIVE DATE: Rule 3a4-1 will become effective July 9, 1985.

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SUPPLEMENTARY INFORMATION:

I. Introduction

The Commission today announced the adoption of Rule 3a4-1 (17 CFR 240.3a4-1) under the Securities Exchange Act of 1934 (the "Act").¹ Rule 3a4-1 was most recently proposed for public comment in May, 1984.² The Rule provides a non-exclusive safe harbor from the broker-dealer registration provisions of the Act for certain associated persons of issuers. The Rule specifies that an associated person of an issuer must meet three preliminary conditions and any one of three alternative conditions in order to take advantage of the safe harbor.

As stated in the 1984 Release, a person acting on behalf of an issuer in buying or selling that issuer's securities may, depending upon the circumstances, be a broker within the meaning of the Act. The term "broker," as defined in section 3(a)(4) of the Act, generally includes any person engaged in the business of effecting transactions in securities for the account of others. Section 15(a) of the Act requires broker-dealers to register with the Commission unless an exemption is available and comply with applicable provisions of the securities laws.³

Questions concerning the need for broker-dealer registration frequently have arisen when an issuer proposes to sell its securities through its officers, partners or employees rather than incurring the costs of employing the

services of a registered broker-dealer. The staff has historically responded to these questions by providing interpretive advice or issuing no-action letters. The Commission believes that a safe harbor rule is an appropriate and efficient way to provide guidance in this area.

Commentators generally supported adoption of the proposed Rule. In particular, they noted that the Rule would be useful in clarifying an aspect of broker-dealer registration. Upon review of the repropoed Rule and consideration of the comments received, the Commission has determined to adopt the Rule substantially as proposed, to make some clarifications as described in this Release and to adopt some suggested modifications to the Rule.⁴

The broker-dealer registration and associated regulatory requirements of the Act, as well as those of the self-regulatory organizations, provide important safeguards to investors. Investors are assured that registered broker-dealers and their associated persons have the requisite professional training and that they must conduct their business according to regulatory standards. Registered broker-dealers are subject to a comprehensive regulatory scheme designed to ensure that customers are treated fairly, that they receive adequate disclosure and that the broker-dealer is financially capable of transacting business. Exemptions from registration have traditionally been narrowly drawn in order to promote both investor protection and the integrity of the brokerage community. At the same time, however, the Commission recognizes that there are situations where imposition of the registration requirement would be inappropriate.

Compliance with the conditions to the safe harbor of Rule 3a4-1 is not the exclusive means by which associated persons of issuers may sell that issuer's securities without registration as broker-dealers. Accordingly, paragraph (b) of the Rule provides that no presumption shall arise that a person associated with an issuer has violated section 15(a) in connection with the sale of the issuer's securities if the conditions of the Rule are not met. The Commission recognizes that there may be other facts and circumstances that justify a conclusion that registration as a broker-dealer is not required even though all the

⁴The Commission received eight comment letters regarding repropoed Rule 3a4-1. File No. S7-19-84 contains these public comment letters as well as a summary of comments prepared by the staff of the Commission.

conditions of the Rule have not been satisfied. The staff will continue to provide interpretive guidance to those whose activities are not clearly within the provisions of the Rule. Rule 3a4-1, however, does provide legal certainty to those persons whose activities meet the conditions of the Rule.

II. Rule 3a4-1

A. Scope of the Rule

Rule 3a4-1 provides a safe harbor from broker-dealers registration for associated persons of an issuer. The term "associated person of an issuer" is defined in paragraph (c)(1) of the Rule as any natural person who is a partner, officer, director or employee of the issuer, of a corporate general partner of a limited partnership that is the issuer or of a company or partnership that controls, is controlled by or under common control with the issuer.⁵ The term "associated person of an issuer" includes certain persons affiliated with a corporate general partner of a partnership which is the issuer. These persons are included because most partnerships issuing securities are controlled solely by one or more corporate general partners. The Commission has concluded that in those circumstances where officers, directors, or employees of a corporation are engaged in the sale of securities issued by a limited partnership in which the corporation is a general partner, and the sales are conducted in a manner consistent with the limitations and restrictions set forth in Rule 3a4-1, such persons should not be deemed to be brokers. Similarly, the Commission believes that it is also appropriate to include employees of companies or partnerships in a control relationship with the issuer within the scope of the Rule.

The term "associated person of the issuer" also includes employees of an investment adviser to an issuer that is an investment company registered under the Investment Company Act of 1940. The investment adviser must be registered under the Investment Advisers Act of 1940. This part of the

⁵ While Rule 3a4-1 focuses on the activities of natural persons, it also may have an impact on their employers. For example, if the employees of a corporate general partner sell securities of the issuer-limited partnership in compliance with Rule 3a4-1, neither the employees nor the corporate general partner would be required to register as a broker-dealer. However, where a corporate general partner, through its employees, sells the issuer-limited partnership's securities and pays the employees a sales commission, the corporate general partner is acting as a broker-dealer and must register as such. The employees would be associated persons of the broker-dealer.

¹ 15 U.S.C. 78 *et seq.*

² Securities Exchange Act Release No. 20943 (May 9, 1984), 49 FR 20512 (May 15, 1984) ("1984 Release"). Rule 3a4-1 was initially proposed for public comment in Securities Exchange Act Release No. 13195 (Jan. 21, 1977), 42 FR 5084 (Jan. 27, 1977).

³ Section 15(a)(1), 15 U.S.C. 78o(a)(1), provides that: [i]t shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use 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) unless such broker or dealer is registered in accordance with section 15(b) of the Act (15 U.S.C. 78o(b)).

definition of associated person reflects comments received on the original rule proposal and codifies the position taken by the staff in its no-action letters.⁶ Several commentators on the 1984 Release questioned whether the definition should be further expanded to include third party affiliates of the investment adviser. The Commission believes any relief from the broker-dealer registration requirement for such third party affiliates is best handled through the no-action letter process on a case-by-case basis.

Paragraph (a)(3) of the Rule excludes associated persons of an issuer, who, at the time of their participation in the sale of the issuer's securities, are associated persons of a broker or dealer.⁷ Paragraph (c)(2) of the Rule defines the term "associated person of a broker or dealer" as it is defined in section 3(a)(18) of the Act.⁸ These persons have been excluded from the scope of the Rule for two reasons. First, integration of the brokerage activities performed by them in the course of their employment with the broker-dealer and the sales of securities effected on behalf of the issuer would lead to the conclusion that, in most circumstances, such persons would be brokers within the meaning of the Act. Second, the potential for abusive sales tactics or confusion of investors stemming from the dual affiliation of the associated person would appear to warrant regulatory supervision.⁹

⁶ Letters dated June 27, 1983, from Linda Lewis, Attorney, Office of Chief Counsel, Division of Market Regulation, to Lawrence, Lawrence, Kamin & Saunders; Oct. 10, 1974, from Francis R. Snodgrass, Chief Counsel, Division of Market Regulation to CNA Management Corporation, and LaSalle Fund Inc. [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,969 (Dec. 31, 1970).

⁷ If an associated person of an issuer is also a registered broker-dealer, the federal securities laws would require such a person to disclose adequately to all purchasers his affiliation with the issuer. See, e.g., Rule 15c1-5.

⁸ The term associated person of a broker or dealer means: any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, except any person associated with a broker or dealer whose functions are solely clerical or ministerial. . . .

⁹ In the past, the staff has not objected to the sale of an issuer's securities by a person associated with a broker-dealer where the broker-dealer does not participate in the sale but assumes full responsibility for the activities of its associated person and the affiliation is fully disclosed to investors. In such a situation, the associated person of the broker-dealer is supervised by the broker-dealer and is qualified to sell securities under applicable rules of the federal securities laws. Therefore, the safe harbor of Rule 3a4-1 is not necessary or available to such persons. The staff will continue to handle such situations on a case-by-case basis. Under the rules of the self-regulatory

Commentators on the original proposal suggested that the scope of the Rule should be expanded to cover attorneys, accountants, insurance brokers, financial service organizations, and financial consultants who for a fee assist promoters and other issuers in the sale of securities. One commentator on the repropoed Rule, however, stated that such "independent agents" should not have the protection of the safe harbor and should be required to register as broker-dealers. The Commission has concluded that it would not be appropriate to expand the scope of the Rule to cover such persons, although the staff of the Division of Market Regulation may provide interpretive advice on a case-by-case basis. Insofar as they are retained by an issuer specifically for the purpose of selling securities to the public and receive transaction-based compensation, these persons are engaged in the business of effecting transactions in securities for the account of others. Accordingly, these persons should register as broker-dealers.

The safe harbor of the Rule is available in the context of all sales of securities of the issuer by a person associated with that issuer in a transaction on behalf of that issuer. The term "sale," as used in paragraph (a) of the Rule, includes "any contract to sell or otherwise dispose of" securities and thus would include transactions that are part of any public or private offering.¹⁰ The term "securities of the issuer" is intended to cover the issuer's sale of its own securities through its associated persons. The Rule does not address situations where an issuer's employees assist potential buyers and sellers in connection with secondary market transactions in the issuer's securities.¹¹

B. The Preliminary Requirements Applicable to Associated Persons

Paragraph (a) of the Rule contains three preliminary conditions that must be met by associated persons in order to take advantage of the safe harbor. The

organizations, the associated person is required to provide prior written notice to the broker-dealer employer of his intention to effect transactions on behalf of others outside the scope of his employment. The member may also request copies of all documents and statements relating to the transaction. See Rules of Fair Practice Art. III, Section 27, NASD Manual (CCH), ¶ 2177 and NASD Notice to Members, 85-21 (March 29, 1985) (proposing amendments to Section 27). The New York Stock Exchange imposes a similar requirement on associated persons of its members. See NYSE Rule 346.

¹⁰ See section 3(a)(14) of the Act.

¹¹ In such circumstances, questions also may arise concerning the application of the registration provisions of the Securities Act of 1933 ("1933 Act").

associated person must not be subject to a statutory disqualification, must not receive, directly or indirectly, commissions or transaction-based compensation in connection with the sale of the issuer's securities, and must not be an associated person of a broker or dealer.

Paragraph (a)(1) specifies that the associated person may not be subject to a statutory disqualification, as that term is defined in section 3(a)(39) of the Act, at the time of his participation in the sale of the issuer's securities. In the 1984 Release, the Commission requested comments on whether the application of the statutory disqualification provision of the Rule should be narrowed to disqualifications relating to sales of securities or other broker-dealer activities. The two commentators that addressed this point did not favor narrowing the requirement. The Commission has concluded that any person subject to proceedings or convicted of any of the violations described in section 3(a)(39) of the Act should not be able to rely on the safe harbor from broker-dealer registration. The Commission believes that there is added potential for abusive practices in the sale of an issuer's securities in circumstances where persons who are subject to a statutory disqualification participate without assurance of adequate supervision or regulatory oversight.

Paragraph (a)(2) specifies that the associated person may not be compensated in connection with the sale of the issuer's securities by the payment of commissions or other remuneration based on transactions in securities.¹² In determining whether an associated person is a "broker," the receipt of transaction-based compensation often indicates that such a person is engaged in the business of effecting transactions in securities. Compensation based on transactions in securities can induce high pressure sales tactics and other problems of investor protection which require application of broker-dealer regulation under the Act.

Whether a particular compensation arrangement is "other remuneration" based either directly or indirectly on transactions in securities depends on all of the particular facts and circumstances. For example, in determining whether a particular compensation arrangement involving the

¹² In response to comments received, the language of this paragraph has been modified to make it clear that the associated person may not be compensated, "directly or indirectly," by the payment of commissions or other remuneration based on transactions in securities.

payment of bonuses would not be permissible under the Rule, the following factors may be relevant: (1) When the offering commences and concludes; (2) when the bonus is paid; (3) when it is determined that a bonus will be paid; (4) when associated persons are informed of the issuer's intention to pay bonus; and (5) whether the bonus paid to particular associated persons varies with their success in selling the issuer's securities.

Paragraph (a)(3) specifies that the associated person must not be, at the time of his participation, an associated person of a broker or dealer. Paragraph (c)(2) of the Rule defines an "associated person of a broker or dealer." One commentator suggested that, as an additional preliminary requirement, the Rule should not be available to a person who was an associated person of a broker-dealer or investment adviser within the previous twelve months. This twelve month requirement was proposed as a condition to the second alternative of the safe harbor. The effect of this suggestion to include the twelve month requirement in the preliminary requirement would be to require all persons formerly engaged in the securities business to wait one year before helping an issuer sell its securities under the safe harbor of Rule 3a4-1. The rationale for the one year limitation, as stated in the 1984 Release, is particularly important under the second alternative, which allows full public sales solicitations. The one year limitation would appear to impose an unnecessary burden under the first alternative, where sales are limited to certain financially sophisticated persons and to sales in other limited circumstances, or the third alternative, where "cold call" type solicitation is not permissible.

Finally, one commentator suggested that the Rule should include limitations based on the issuer's volume of sales in relations to its size. It would be difficult to create a volume limitation that would be equitable to all issuers. Furthermore, the other restrictions contained in Rule 3a4-1 are sufficient to ensure that the concerns underlying broker-dealer registration are not applicable. Therefore, no such change has been included in the Rule.

C. The First Alternative Available to Associated Persons

The safe harbor provided by Rule 3a4-1 is available to an associated person of an issuer if, in addition to meeting the preliminary requirements of paragraphs (a)(1)-(3), he meets the conditions to one of three alternatives set forth in paragraphs (a)(4)(i)-(iii).

The first alternative in paragraph (a)(4)(i) is available to an associated person of an issuer if he restricts his participation in any of four ways. Paragraph (a)(4)(i)(A) of the Rule specifies that associated persons of an issuer may offer and sell securities to various financial institutions and intermediaries, such as registered broker-dealers.¹³ The Commission believes it is appropriate to include within the safe harbor sales to such institutions and intermediaries given the level of their financial sophistication.

One commentator stated that this provision generally should not be available to so-called "wholesalers," that is, employees of issuers that market securities to registered broker-dealers, but who do not have any contact with potential investors. This commentator suggested that the Rule should not be available in this context unless the broker-dealer takes the securities for investment purposes. If the employees do not receive transaction-based compensation and otherwise meet the requirements of Rule 3a4-1, the Commission does not believe that the Rule should exclude such persons, particularly in light of the fact that in such circumstances the ultimate sales to the public will be made through registered broker-dealers.¹⁴

In the 1984 Release, the Commission requested comments on whether sales to other persons or entities should be included in the Rule, such as sales to all categories of "accredited investors," as defined in Rule 501(a) under the Securities Act of 1933 (the "1933 Act"). The commentators were divided on whether the first alternative should be extended to include sales to all "accredited investors." Two commentators concluded that an accredited investor is capable of requiring an issuer to make full disclosure about the issue and of protecting himself from any selling pressures exerted by the issuer's employees. Two other commentators argued that the 1933 Act provisions are related to the need for informational disclosure to potential purchasers and not to the need for registration of securities professionals.

¹³ The Rule also includes sales to registered investment companies (or registered separate accounts), insurance companies, banks, savings and loan associations, and trust companies or similar institutions supervised by a state or federal banking authority and registered investment advisers which are either trustees or are authorized in writing to make investment decisions for trusts.

¹⁴ This part of the Rule is consistent with previous staff interpretations. See, e.g., letter to Ballard & Cardell Corp. (Sept. 14, 1973).

The Commission has determined not to include sales to all 1933 Act accredited investors. The fact that the Commission has concluded that, under limited circumstances, investors do not need the protections afforded by registration under the 1933 Act does not dictate a conclusion that a broad exemption from broker-dealer registration is appropriate. Existing Commission rules and those of the self-regulatory organizations that ensure adequate supervision, among other things, seem no less important in this context than in others.

As repropoed, paragraph (a)(4)(i)(B) of the Rule provided a safe harbor for transactions in securities exempt from registration under sections 3(a)(7) and 3(a)(9) of the 1933 Act.¹⁵ The Commission requested comments on whether this alternative should be expanded to include sales of all securities exempt under section 3(a) of the 1933 Act. One commentator suggested that securities exempt under sections 3(a)(3), 3(a)(8), 3(a)(10) and 3(a)(11) should be included within the safe harbor. The Commission has decided that the addition of securities covered by section 3(a)(10) of the 1933 Act would be appropriate.¹⁶ Transactions in such securities, like transactions in securities covered by sections 3(a)(7) and 3(a)(9), are sufficiently restricted that application of the broker-dealer regulatory scheme is not necessary.

The Commission has not expanded the safe harbor to include all other 1933 Act exempt securities.¹⁷ The purpose of

¹⁵ Section 3(a)(7) exempts "certificates issued by a receiver or debtor in possession in a case under title 11 of the United States Code, with the approval of the court." 15 U.S.C. 77c(a)(7). Section 3(a)(9) exempts "except with respect to a security exchanged in a case under title 11 of the United States Code, any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." 15 U.S.C. 77c(a)(9).

¹⁶ Section 3(a)(10) exempts "except with respect to a security exchanged in a case under title 11 of the United States Code, any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval." 15 U.S.C. 77c(a)(10).

¹⁷ Persons who effect only transactions in securities exempt under sections 3(a)(3), 3(a)(8) and 3(a)(11) of the 1933 Act are already exempt from the broker-dealer registration provisions of the Act. The

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the securities registration provisions of the 1933 Act (or exemption from registration) is not the same as the purpose of the broker-dealer registration requirement of the Act. Regardless of the amount of disclosure provided to investors, investors need the additional protection offered by the Act including the assurance that the salesman who offers the securities understands and appreciates both the nature of the security and the needs of the buyer.¹⁸

Paragraph (a)(4)(i)(C) and (a)(4)(i)(D) of the Rule remain unaltered. Paragraph (a)(4)(i)(C) provides a safe harbor for securities transactions in connection with reorganizations reclassifications, and acquisitions which are "made pursuant to a plan submitted for the approval of security holders who will receive securities of the issuer." Paragraph (a)(4)(i)(D) of the Rule includes within the safe harbor sales by associated persons pursuant to a pension, profit-sharing, or other similar employee benefit plans and dividend reinvestment plans.

D. The Second Alternative Available to Associated Persons

The safe harbor provided by Rule 3a4-1 is also available to an associated person of an issuer if that person meets the conditions set forth in paragraph (a)(4)(ii), the second alternative. Those conditions generally require that the associated person primarily perform substantial duties for the issuer otherwise than in connection with transactions in securities; that the associated person was not a broker or dealer or an associated person of a broker or dealer within the preceding twelve months; and that the associated person has not participated in selling an offering to securities on behalf of any issuer within the preceding twelve months other than in reliance of paragraphs (a)(4)(i) or (a)(4)(iii) of Rule 3a4-1. The Rule as adopted contains a limited exception to this one year prohibition for certain sales of securities registered under Rule 415 of the 1933 Act.

Act, in language similar to section 3(a)(3) of the Securities Act, excludes from the definition of security "any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." In addition, 1933 Act section 3(a)(8) securities are not defined as securities under the Act. Finally, section 15(a) of the Act contains an exemption from broker-dealer registration for a broker or dealer whose activities are "exclusively intrastate". Section 3(a)(11) of the 1933 Act also exempts intrastate offerings.

¹⁸ See, e.g., Securities and Exchange Commission, *Report of Special Study of Securities Markets*, Part I, 588, H.R. Doc. No. 94, 86th Cong., 1st Sess. (1963).

Paragraph (a)(4)(ii)(A) of the Rule provides the safe harbor to associated persons who either perform, or are intended to perform, substantial duties for the issuer otherwise than in connection with transactions in securities. Thus, it would not be available to person hired by the issuer specifically for the purpose of selling securities, or to associated persons who sell securities on behalf of the issuer as a primary responsibility or on a frequent basis. Whether the associated person's duties otherwise than in connection with the sale of securities, are "substantial" can be measured in terms of a percentage of time worked and the volume or work performed on matters not related to the sale of securities. The Rule does not provide that a specific period of time should be used in determining whether the associated person performs substantial other duties. That time period will depend on all of the relevant facts and circumstances.

The safe harbor generally would be available to associated persons participating in an initial offering of an issuer where, because of the "start-up" nature of the issuer, the associated persons are not engaged in any activities other than those relating to the offering. The safe harbor would be available to such associated persons if they will primarily perform or are intended to perform substantial other duties for the issuer at the end of the offering.

Paragraph (a)(4)(ii)(B) of the Rule specifies that the associated person may not have been a broker or dealer or an associated person of a broker or dealer within the preceding twelve months.¹⁹ Such persons may have the incentive to solicit former clients and to capitalize on any trust relationship that had been established with those persons in connection with securities transactions. Even assuming full disclosure by these persons of their changed status, (i.e., that they are no longer registered securities professionals), their solicitation or recommendation may unduly influence the former client's investment decision. In addition, the securities sales activities by such persons would lead frequently to the conclusion that such persons were engaged in the business of effecting securities transactions and should be registered as broker under the Act.

One commentator noted that the Rule as repropounded was not clear with respect to whether the term "broker-

¹⁹ In response to concerns raised by several commentators, paragraph (a)(4)(ii)(B) does not include former investment advisers.

dealer" applied to registered "issuer-dealers" under state law. Paragraph (c)(2) of the Rule has been amended to clarify that employees or former employees of such "issuer-dealer" or similar entity may use the safe harbor. The staff will provide interpretive advice to those issuers that request such advice.

Paragraph (a)(4)(ii)(C) of the Rule specifies that the associated person may not have sold securities on behalf of any issuer within the previous twelve months other than in reliance on paragraph (a)(4)(i) or (a)(4)(iii) of the Rule. The Commission continues to believe this one year limitation on sales under the second alternative is necessary.

Historically, the frequency with which persons engage in transactions in securities has been a factor in making a determination as to whether those persons are engaged in that business within the meaning of the statutory definition. The Commission continues to believe that broker-dealer registration is appropriate and necessary with respect to persons who are regularly engaged in the sale of securities, such as promoters of limited partnership interests. Accordingly, the condition that the person relying on the safe harbor not have sold securities on behalf of any issuer during the preceding twelve months, coupled with the requirement that the person perform substantial other duties on behalf of the issuer, will preclude the continuous, repeated or multiple sales of securities by persons absent broker-dealer registration.²⁰

The Commission has, however, determined that the one year limitation on sales under the second alternative should be modified for certain sales of securities registered under Rule 415 of the 1933 Act. Rule 415 allows issuers to register certain securities and place them "on the shelf" for periods in excess of one year.²¹ Rule 3a4-1 as repropounded in 1984 would limit those issuers that wished to take advantage of the safe harbor to a one year shelf offering. Therefore, the Commission has amended paragraph (a)(4)(ii)(C) of Rule

²⁰ There would be substantial broker-dealer concerns raised where an issuer might choose to "rotate" employees every twelve months to sell securities. Under those circumstances, it may be doubtful whether in fact the employees had substantial duties for the issuer other than the sale of securities.

²¹ The amount of securities that can be registered for offerings pursuant to Rule 415(a)(1) (viii)-(x) is limited to the amount which, at the time the registration statement becomes effective, is reasonably expected to be offered and sold within two years of the initial effective date. Other 415 offerings are not subject to time provisions.

3a4-1 to allow any issuer that engages in Rule 415 offerings to take advantage of the full offering periods possible under that rule. Thus, for Rule 415 offerings, the twelve month restriction on sales by associated persons would begin at the end of the Rule 415 offering. For example, an associated person of an issuer that sold securities on the first day allowed under the Rule 415 offering could continue to sell those securities until the entire offering was closed even if the offering lasted over twelve months. At the close of the Rule 415 offering, the twelve month restriction would apply and that associated person would not be able to sell securities for any issuer, except in reliance on paragraphs (a)(4)(i) or (a)(4)(iii) of Rule 3a4-1 for the succeeding twelve month period. During that succeeding twelve month period, the associated person would be prohibited from using the safe harbor to sell securities of any issuer, including, for example, other issues sold involving the same general partner.

Commentators on the reproposed Rule made several suggestions to expand Rule 3a4-1 to allow continuous distributions of securities by certain classes or groups of issuers. Two commentators suggested that mutual funds should be allowed to conduct continuous distributions under paragraph (a)(4)(ii). Most mutual funds currently distribute their products either through independent broker-dealers or through their own special purpose broker-dealers. The industry argued that since they are already heavily regulated, the extra regulation under section 15(a) of the Act is unnecessary. The broker-dealer regulatory scheme, however, provides protection to investors not available under the Investment Company Act of 1940 or the Investment Advisers Act of 1940. The Commission believes that broker-dealer registration and regulation is necessary when the associated persons of an issuer engage in active sales promotion of the issuer's securities on a continuous basis.²²

Commentators also suggested that certain special purpose broker-dealers such as consumer finance companies and investment company affiliates be allowed to conduct their business without registration as broker-dealers. These commentators suggested that the Commission eliminate the twelve month limitation between sales in the second alternative. The Commission believes

²² The staff has, however, issued no-action letters regarding the application of the broker-dealer registration requirement to the sales force of investment companies, including associated persons of a registered investment adviser, where their activities were limited to passive sales. See *supra* n. 6, at 6.

that where issuers are using employees to sell their securities on a near continuous basis, the policy reasons underlying registration apply. In particular, the protections available under the broker-dealer regulatory scheme are necessary to ensure that investors obtain reliable advice and service from those persons selling securities. Therefore, the Commission has not adopted this suggestion.

One commentator noted that the Rule could be interpreted to permit an issuer's employees to make only one sale to a customer, instead of being able to participate in a complete offering. The language of Rule 3a4-1 now specifies that associated persons may participate in an offering to its completion, at which time the twelve month restriction would begin.

E. The Third Alternative Available to Associated Persons

The third alternative under Rule 3a4-1 is available to associated persons of an issuer who conducts only "passive" sales efforts. Of the six commentators that discussed the third alternative, four approved of the alternative and two urged that such passive sales should not be allowed or should be limited to sales by officers and directors. The two commentators that objected to passive sales stated that sales abuses were possible since persons responding to investor inquiries by telephone could pressure the investor into purchasing securities in a manner similar to the "cold calls" that the third alternative of the Rule does not permit. These commentators also raised concerns regarding difficulties in ensuring compliance with the passive sales condition without inspections by the NASD or the Commission. The four commentators that approved of the alternative did not perceive any such problems and suggested some expansion of the Rule.

The Commission has retained the third alternative with some modifications designed to address the commentators' concerns. With these modifications, the limited sales activity identified in this alternative does not raise significant potential for abuse. Moreover, because of the issuer's potential liability under the securities laws for wrongful conduct of its employees, the issuer has a strong incentive to carefully circumscribe the sales activities of those persons.²³

²³ Among other things, the antifraud provisions of the federal securities laws prohibit misrepresentations and omissions of material fact in connection with the sale of securities. See section 17 of the 1933 Act and section 10(b) of the Act. In

Paragraph (a)(4)(iii)(A) allows associated persons of an issuer to prepare and deliver any written communications through the mails or other similar means that do not involve oral solicitation by the associated person of potential purchasers. This activity would include the drafting or editing of sales literature. In order to provide some control over the content of the written communications, however, all such communications must be approved by a partner, officer or director of the issuer. Oral solicitation of a potential purchaser by the associated person would make this alternative unavailable.

Paragraph (a)(4)(iii)(B) of the Rule provides that associated persons can respond to inquiries from potential purchasers in conversations initiated by the purchaser in response to the issuer's original written communication. This provision is intended to permit associated persons to provide information in response to inquiries from potential purchasers about the issuer and the offering. This part of the Rule has been modified to limit permissible responses to information contained in the registration statement filed with the Commission under the 1933 Act or other offering document.²⁴ This provision does not encompass "cold calls" or telephone solicitations of the public.²⁵ In response to commentators' requests for clarification, however, the term "conversation" has been changed to "communication." The broader term "communication" is used to clarify that associated persons of an issuer that receive oral or written communications from potential purchasers in response to previously sent written communications may respond either orally or in writing to such investor-initiated communications.

One commentator suggested that meetings between investors and associated persons of the issuer concerning the issuer and its securities should be permitted under the third alternative. Since this alternative is

in addition, the issuer might be liable for a violation of section 15(a) of the Act if its associated persons' activities are not within the safe harbor and they would otherwise be required to register as broker-dealers.

²⁴ As discussed below, however, paragraph (a)(4)(iii)(C) of the Rule allows associated persons to perform ministerial or clerical work involved in effecting transactions. This would include responding to questions of a clerical or ministerial nature.

²⁵ For example, while the Rule would permit associated persons to respond to inquiries from potential purchasers, the mere fact of an inquiry would not justify additional telephone contact with that customer beyond the contact necessary to respond to the customer inquiry.

designed to allow primarily passive sales activities, the Commission believes such meetings should not be specifically included in the Rule. In some instances, these kinds of meetings could be used to pressure investors into purchasing securities. Nevertheless, there may be some circumstances where meetings with investors that are not solicited by the issuer could be permitted without raising broker-dealer registration concerns. The staff will consider such circumstances on a case-by-case basis through the no-action letter process.

Paragraph (a)(4)(iii)(C) of the Rule allows associated persons to perform the ministerial or clerical work involved in effecting transactions. This provision is intended to clarify that associated persons of an issuer will not be deemed to be brokers if they restrict their participation to activities such as bookkeeping entries and arranging for the delivery of stock certificates after a securities transaction has been consummated.

III. Certain Findings, Effective Date and Statutory Basis

Section 23(a)(2) of the Act²⁶ requires the Commission, in adopting rules under the Act, to consider the anticompetitive effect of such rules, if any, and to balance any impact against the regulatory benefits gained in terms of furthering the purposes of the Act. The Commission has considered proposed Rule 3a4-1 in light of the standards cited in section 23(a)(2) and believes that adoption of the amendments will not impose any burden on competition not necessary or appropriate in furtherance of the Act.

Pursuant to the Administrative Procedure Act, 5 U.S.C. 553(b), interested persons were given an opportunity to submit written views on proposed Rule 3a4-1. After consideration of the relevant matters presented, the proposed Rule concerning persons deemed not to be brokers is adopted substantially as proposed with some technical changes for clarity. In response to commentator's suggestions, the proposed Rule has been amended to clarify that both direct and indirect compensation based on transactions in securities make the exemption unavailable. The Rule also now allows, under certain circumstances, sales of Rule 415 securities without broker-dealer registration. The issues with respect to the scope of the safe harbor have been thoroughly considered during the comment period. Extended delay in

adopting the Rule would be costly to investors and issuers.

Rule 3a4-1 grants an exemption from broker-dealer registration. Therefore, pursuant to the Administrative Procedure Act, 5 U.S.C. 553(d), Rule 3a4-1 will become effective immediately upon publication in the Federal Register.

IV. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis in accordance with 5 U.S.C. § 603 regarding Rule 3a4-1. The Analysis notes that the objective of the Rule is to codify past staff positions on the issuer's exemption and provide guidance for future issuers. The Analysis states that no commentators referred to the Initial Regulatory Flexibility Analysis in discussing the application of Rule 3a4-1 to issuers.

A copy of the Final Regulatory Flexibility Analysis may be obtained by contacting Susan J. Walters, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549, (202) 272-2848.

V. Statutory Basis

The Securities and Exchange Commission, acting pursuant to the Act, particularly Sections 3, 15 and 23 thereof (15 U.S.C. 78c, 78o, and 78w) hereby amends Chapter II, Title 17 of the Code of Federal Regulations by adding § 240.3a4-1 thereto.

List of Subjects in 17 CFR Part 240

Securities brokers.

Text of Rule 3a4-1

Chapter II, Title 17 of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 is revised to read as follows:

Authority: Section 23, 48 Stat. 901, as amended (15 U.S.C. 78w); Section 240.3a4-1 also issued under Secs. 3 and 15, 89 Stat. 97, as amended, 89 Stat. 121 as amended. §§ 240.12b-1 to 240.12b-36 also issued under Secs. 3, 12, 13, 15, 48 Stat. 892, as amended, 894, 895, as amended; 15 U.S.C. 78c, 781, 78m, 78o. §§ 240.14c-1 to 240.14c-101 also issued under Sec. 14, 48 Stat. 895; 15 U.S.C. 78n. §§ 240.15b10-1 to 240.15b10-9 also issued under Secs. 15, 17, 48 Stat. 895, 897, Sec. 203, 49 Stat. 704, Secs. 4, 8, 49 Stat. 1379, Sec. 5, 52 Stat. 1076, Sec. 6, 78 Stat. 570; 15 U.S.C. 78o, 78q, 12 U.S.C. 241 nt.

2. In Part 240, § 240.3a4-1 is added as follows:

§ 240.3a4-1 Associated persons of an issuer deemed not to be brokers.

(a) An associated person of an issuer of securities shall not be deemed to be a broker solely by reason of his participation in the sale of the securities of such issuer if the associated person:

(1) Is not subject to a statutory disqualification, as that term is defined in section 3(a)(39) of the Act, at the time of his participation; and

(2) Is not compensated in connection with his participation by the payment of commissions or other remuneration based either directly or indirectly on transactions in securities; and

(3) Is not at the time of his participation an associated person of a broker or dealer; and

(4) Meets the conditions of any one of paragraphs (a)(4) (i), (ii), or (iii) of this section.

(i) The associated person restricts his participation to transactions involving offers and sales of securities:

(A) To a registered broker or dealer; a registered investment company (or registered separate account); an insurance company; a bank; a savings and loan association; a trust company or similar institution supervised by a state or federal banking authority; or a trust for which a bank, a savings and loan association, a trust company, or a registered investment adviser either is the trustee or is authorized in writing to make investment decisions; or

(B) That are exempted by reason of sections 3(a)(7), 3(a)(9) or 3(a)(10) of the Securities Act of 1933 from the registration provisions of that Act; or

(C) That are made pursuant to a plan or agreement submitted for the vote or consent of the security holders who will receive securities of the issuer in connection with a reclassification of securities of the issuer, a merger or consolidation or a similar plan of acquisition involving an exchange of securities, or a transfer of assets of any other person to the issuer in exchange for securities of the issuer; or

(D) That are made pursuant to a bonus, profit-sharing, pension, retirement, thrift, savings, incentive, stock purchase, stock ownership, stock appreciation, stock option, dividend reinvestment or similar plan for employees of an issuer or a subsidiary of the issuer;

(ii) The associated person meets all of the following conditions:

(A) The associated person primarily performs, or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of the issuer otherwise than in connection with transactions in securities; and

²⁶ 15 U.S.C. 78w(a)(2).

(B) The associated person was not a broker or dealer, or an associated person of a broker or dealer, within the preceding 12 months; and

(C) The associated person does not participate in selling an offering of securities for any issuer more than once every 12 months other than in reliance on paragraphs (a)(4)(i) or (a)(4)(iii) of this section, except that for securities issued pursuant to Rule 415 under the Securities Act of 1933, the 12 months shall begin with the last sale of any security included within one Rule 415 registration.

(iii) The associated person restricts his participation to any one or more of the following activities:

(A) Preparing any written communication or delivering such communication through the mails or other means that does not involve oral solicitation by the associated person of a potential purchaser; *provided, however,* that the content of such communication is approved by a partner, officer or director of the issuer;

(B) Responding to inquiries of a potential purchaser in a communication initiated by the potential purchaser; *provided, however,* that the content of such responses are limited to information contained in a registration statement filed under the Securities Act of 1933 or other offering document; or

(C) Performing ministerial and clerical work involved in effecting any transaction.

(b) No presumption shall arise that an associated person of an issuer has violated section 15(a) of the Act solely by reason of his participation in the sale of securities of the issuer if he does not meet the conditions specified in paragraph (a) of this section.

(c) *Definitions.* When used in this section:

(1) The term "associated person of an issuer" means any natural person who is a partner, officer, director, or employee of:

(i) The issuer;

(ii) A corporate general partner of a limited partnership that is the issuer;

(iii) A company or partnership that controls, is controlled by, or is under common control with, the issuer; or

(iv) An investment adviser registered under the Investment Advisers Act of 1940 to an investment company registered under the Investment Company Act of 1940 which is the issuer.

(2) The term "associated person of a broker or dealer" means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or

indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial and any person who is required under the laws of any state to register as a broker or dealer in that state solely because such person is an issuer of securities or associated person of an issuer of securities shall not be included in the meaning of such term for purposes of this section.

By the Commission.

John Wheeler,

Secretary.

June 27, 1985.

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