

SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(59 DOCUMENTS)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3695 / October 17, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15573

In the Matter of

Edwin V. Gaw,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Edwin V. Gaw ("Gaw" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent Gaw, 48, resides in Weston, Massachusetts.

2. From 2009 through 2013, Gaw was the managing director of investments for OM Investment Management, LLC ("OM Management"), a Florida limited liability company that was established as an investment adviser and was registered with the Commission until July 15, 2013. During this time, Gaw acted as an investment adviser to individual clients, some of whom invested in OM Global Investment Fund LLC ("OM Global"), an unregistered fund formed for the purpose of making investments in securities. OM Management was the managing member of OM Global. Gaw executed an investment agreement on behalf of OM Global, entered into investment advisory agreements with OM Management clients who invested in OM Global, and made representations on behalf of the fund.

3. On October 9, 2013, the United States District Court for the Southern District of Florida entered a judgment by consent against Gaw in the civil action entitled Securities and Exchange Commission v. OM Investment Management, LLC, et al., Case No. 13-CV-23486-JEM, permanently enjoining Gaw from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and Sections 206(1), 206(2), 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

4. The Commission's complaint alleged, inter alia, that Gaw, as an investment adviser, made material misrepresentations and omissions concerning the composition of OM Global, misrepresented that the fund would conduct annual audits and utilize a third party administrator and sub-adviser, and entered into an unauthorized transaction.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Gaw's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, Gaw be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served

as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3694 / October 17, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15572

In the Matter of

Gignesh Movalia,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Gignesh Movalia ("Movalia" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent Movalia, 37, resides in Land O' Lakes, Florida.
2. From 2007 through 2013, Movalia, among other things, was the managing member of OM Investment Management, LLC ("OM Management"), a Florida limited liability company that was established as an investment adviser and was registered with the Commission until July 15, 2013. During this time, Movalia acted as an investment adviser to OM Global Investment Fund LLC ("OM Global"), an unregistered fund formed for the purpose of making investments in securities, and individual clients, some of whom invested in OM Global. OM Management and Movalia were the managing members of OM Global. Movalia made investment decisions on behalf of OM Global and the individual clients, received and disbursed funds, created offering materials, and controlled OM Global's accounts.
3. On October 9, 2013, the United States District Court for the Southern District of Florida entered a judgment by consent against Movalia in the civil action entitled Securities and Exchange Commission v. OM Investment Management, LLC, et al., Case No. 13-cv-23486-JEM, permanently enjoining Movalia from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-8 thereunder; and from aiding and abetting future violations of Sections 203A and 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and Section 7(a) of the Investment Company Act of 1940.
4. The Commission's complaint alleged, inter alia, that Movalia, as an investment adviser to OM Global, engaged in fraudulent conduct, including making material misrepresentations and omissions concerning performance, net asset values, and portfolio composition, providing fabricated and misleading account statements, entering into undisclosed related party transactions, entering into unauthorized transactions, misrepresenting that the fund would conduct annual audits and utilize a third party administrator and sub-adviser, and misappropriating client funds. In addition, the Commission's complaint alleged that Movalia made false filings with the Commission, failed to register OM Global and the offer and sale of its securities with the Commission, improperly registered OM Management as an investment adviser with the Commission, and failed to have OM Management have a surprise annual examination or audited financial statements with respect to OM Global as required for registered investment advisers.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Movalia's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, Movalia be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

November 8, 2013

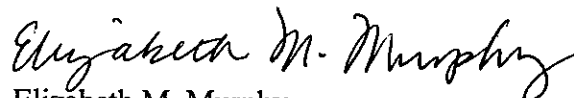
<u>In The Matter Of</u>	:	
	:	
<u>Far Vista Petroleum Corp.</u>	:	ORDER OF SUSPENSION
	:	OF TRADING
<u>File No. 500-1</u>	:	

It appears to the Securities and Exchange Commission that the public interest and the protection of investors require a suspension of trading in the securities of Far Vista Petroleum Corp. ("FVSTA") because of questions that have been raised about the accuracy and adequacy of publicly disseminated information concerning, among other things, FVSTA's business prospects, operations, and control. FVSTA is a Nevada corporation based in Levittown, NY. It is quoted on the OTC Link under the symbol FVSTA.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST on November 8, 2013 through 11:59 p.m. EST on November 21, 2013.

By the Commission.


Elizabeth M. Murphy
Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 27, 2014

In the Matter of

Olie, Inc. and Hi Score Corp.

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Olie, Inc. and Hi Score Corp. There are questions regarding the accuracy of publicly available information about both companies' assets, acquisitions, business activities, control persons, securities offerings, and financing arrangements. Olie, Inc. is a Delaware corporation with its principal place of business in Vancouver, Canada. Olie, Inc.'s common stock is quoted on OTC Link operated by OTC Markets Group Inc. ("OTC Link") under the ticker symbol OLIE. Hi Score Corp. is a Florida corporation with its principal place of business in Sunrise, Florida. Hi Score Corp.'s common stock is quoted on OTC Link under the ticker symbol HSCO.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

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THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 27, 2014, through 11:59 p.m. EST on February 7, 2014.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

April 1, 2014

In the Matter of

**Aclor International, Inc.,
Acrongenomics, Inc.,
Diversified Global Holdings Group, Inc.,
FutureIT, Inc.,
Southern Star Energy, Inc., and
W Holding Co., Inc.**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Aclor International, Inc. because it has not filed any periodic reports since it filed a Form 10 registration statement on December 1, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Acrongenomics, Inc. because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Diversified Global Holdings Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of FutureIT, Inc. because it has not filed any periodic reports since the period ended September 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Southern Star Energy, Inc. because it has not filed any periodic reports since the period ended November 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of W Holding Co., Inc. because it has not filed any periodic reports since the period ended September 30, 2009.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on April 1, 2014, through 11:59 p.m. EDT on April 14, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71834 / April 1, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15818

In the Matter of

**Aclor International, Inc.,
Acrongenomics, Inc.,
Diversified Global Holdings Group, Inc.,
FutureIT, Inc.,
Southern Star Energy, Inc., and
W Holding Co., Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Aclor International, Inc., Acrongenomics, Inc., Diversified Global Holdings Group, Inc., FutureIT, Inc., Southern Star Energy, Inc., and W Holding Co., Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Aclor International, Inc. (CIK No. 1092945) is a Delaware corporation located in Laredo, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aclor International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on December 1, 2011. As of March 25, 2014, the company's stock (symbol "MTIZ") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC

Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Acrongenomics, Inc. (CIK No. 1104502) is a defaulted Nevada corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Acrongenomics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2011, which reported a net loss of \$488,443 for the prior six months. As of March 25, 2014, the company's stock (symbol "AGNM") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Diversified Global Holdings Group, Inc. (CIK No. 1451775) is a Florida corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Diversified Global is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011. As of March 25, 2014, the company's stock (symbol "DGHG") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. FutureIT, Inc. (CIK No. 1421481) is a void Delaware corporation located in Lod, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FutureIT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$818,682 for the prior nine months. As of March 25, 2014, the company's stock (symbol "FITI") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Southern Star Energy, Inc. (CIK No. 1341315) is a revoked Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Southern Star is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2009, which reported a net loss of \$6,463 for the prior six months. As of March 25, 2014, the company's stock (symbol "SSEY") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. W Holding Co., Inc. (CIK No. 1084887) is a Puerto Rico corporation located in Mayaguez, Puerto Rico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). W Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009. As of March 25, 2014, the company's stock (symbol "WHCI") was quoted on OTC Link, had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2

or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71847 / April 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15819

In the Matter of

ALAN SHEINWALD AND
ALLIANCE ADVISORS LLC,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS PURSUANT TO
SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL
SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Alan Sheinwald ("Sheinwald") and Alliance Advisors LLC ("Alliance" or together with Sheinwald, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings and the findings contained in Section III.3. below, which are admitted, Respondents consent to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

1. Sheinwald is the founder and former president of Alliance. Sheinwald does not have any securities licenses and has never been registered with the Commission in any capacity; however, for at least a portion of the time in which Sheinwald engaged in the conduct underlying the complaint described further below, Sheinwald acted as an unregistered broker. Further, Sheinwald participated in one offering of China Yingxia International, Inc. ("China Yingxia") stock, which was a penny stock. Sheinwald, 48 years old, is a resident of the state of New York.

2. Alliance is an investor relations firm that works with small public companies. Alliance has never been registered with the Commission in any capacity; however, for at least a portion of the time in which Alliance engaged in the conduct underlying the complaint described further below, Alliance acted as an unregistered broker. Further, Alliance participated in one offering of China Yingxia stock, which was a penny stock.

3. On March 17, 2014, a final judgment was entered by consent against Sheinwald and Alliance in the civil action entitled Securities and Exchange Commission v. Alan Sheinwald and Alliance Advisors LLC, Civil Action Number 12-Civ-5811, in the United States District Court for the Southern District of New York, permanently enjoining Sheinwald and Alliance from violating Section 15(a) of the Exchange Act. Under the final judgment, Sheinwald and Alliance are jointly and severally liable to pay disgorgement in the amount of \$177,166, plus prejudgment interest thereon in the amount of \$18,022, and Sheinwald and Alliance are each liable to pay civil penalties in the amount of \$25,000.

4. The Commission's complaint alleged that Sheinwald and Alliance acted as unregistered brokers in connection with securities offerings for at least two publicly traded companies. The complaint further alleged, among other things, that Sheinwald and Alliance received transaction-based compensation in exchange for actively soliciting investors to participate in securities offerings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents Sheinwald and Alliance Advisors' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b) of the Exchange Act that Respondents Sheinwald and Alliance Advisors be, and hereby are:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; barred from participating in any offering of a

penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, with the right to apply for reentry after two years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondents will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondents, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3807 / April 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15821

In the Matter of

JEFFREY M. SEMANSCIN,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jeffrey M. Semanscin ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Semanscin is the general partner of Ibex Omega Private Equity Limited Partnership, a limited partnership organized in Massachusetts in 2009. From June 2007 to December 2013, Semanscin acted as an unregistered investment adviser in connection with Ibex Omega Private Equity Limited Partnership. From February 1999 through July 2002, and from January 2005 to August 2006, Semanscin was also a registered representative associated with broker-dealers and investment advisers registered with the Commission. Semanscin, 39 years old, is a resident of Barnstable, Massachusetts.

2. On April 2, 2014, Semanscin pled guilty to one count of willful violation of the Investment Advisers Act of 1940 (15 U.S.C. Sections 80b-6(1), (2), & (4), & 80b-17)), before the United States District Court for the District of Massachusetts, in United States v. Semanscin, Case No. 1:14-mj-07011-JCB-1.

3. The count of the criminal information to which Semanscin pled guilty alleged, inter alia, that Semanscin, being an investment adviser, through the direct and indirect use of instrumentalities of interstate commerce, willfully employed devices, schemes, and artifices to defraud one or more clients and prospective clients; willfully engaged in transactions, practices, and courses of business that operated as a fraud and deceit upon clients and prospective clients; and willfully engaged in acts, practices, and courses of business that were fraudulent, deceptive, and manipulative.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Semanscin's Offer.

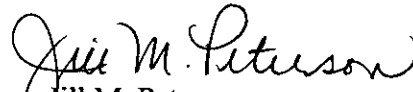
Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Semanscin be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order;
and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct
that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71849 / April 3, 2014

WHISTLEBLOWER AWARD PROCEEDING

File No. 2014-3

In the Matter of the Claims for Awards

in connection with

Redacted

Notice of Covered Action Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

Two individuals Claimant #1 and Claimant #2 filed separate whistleblower award claims pursuant to Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-6, in connection with Notice of Covered Action Redacted. #1 claim was timely filed; #2 claim, however, was untimely because #1 did not file it within ninety (90) calendar days of the date of the Notice of Covered Action, as required by Rule 21F-10(b) of the Exchange Act.

The Claims Review Staff ("CRS") issued Preliminary Determinations recommending that both Redacted claims be denied, albeit on separate grounds. Both claimants have now filed responses contesting their respective Preliminary Determination.

For the reasons set forth below, Redacted claims are denied.

I. Enforcement Proceeding and Notice of Covered Action

On Redacted the Commission

Redacted

Redacted

Redacted

The Commission found

Redacted

Redacted

9 of 59

Redacted

Among other relief, the Commission ordered

Redacted

Redacted

On Redacted the Office of the Whistleblower posted Notice of Covered Action
Redacted for the Redacted Matter.

II. Claimant #1 Claim is Denied

A. Background

Effective July 21, 2010, Congress enacted Section 21F of the Exchange Act, "Securities Whistleblower Incentives and Protection," as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").¹ Prior to the enactment of Dodd-Frank, #1 communicated with the Commission and its staff

Redacted

Redacted

Redacted Prior to Dodd-Frank, #1 also corresponded with the staff of the Commission

Redacted

Redacted

After the enactment of Dodd-Frank, according to #1 whistleblower award claim on Form WB-APP, #1 communicated

Redacted

Redacted

B. The Preliminary Determination

On Redacted the CRS issued a Preliminary Determination recommending that #1 claim be denied. The Preliminary Determination concluded that the information provided by #1 prior to July 21, 2010 was not "original information" because it was not submitted after that date, as required by Rule 21F-4(b)(1)(iv) under the Exchange Act. The Preliminary Determination further concluded that the information provided by #1 after July 21, 2010 did not

¹ Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841 (July 21, 2010).

Redacted

lead to a successful action within the meaning of Section 21F(b)(1) of the Exchange Act and Rules 21F-3(a)(3) and 21F-4(c) thereunder.

C. Claimant # Response to the Preliminary Determination

On Redacted #1 submitted a response contesting the Preliminary Determination pursuant to Rule 21F-10(e)(2) under the Exchange Act.³

In #1 response to the Preliminary Determination, #1 asserts that information #1 provided to the Commission resulted in

Redacted

Redacted

#1 argues that #1 was the first to identify and

Redacted

As a result of all of these circumstances, #1 asserts that the information #1 provided also led to the Commission's enforcement action against Redacted

D. Analysis

To be considered for an award under Section 21F, a whistleblower must voluntarily provide the Commission with "original information" that leads to the successful enforcement of a covered judicial or administrative action or related action. 15 U.S.C. § 78u-6(b)(1). Under Rule 21F-4(b)(1)(iv), information will be considered "original information" only if it was provided to the Commission for the first time after July 21, 2010. 17 C.F.R. § 240.21F-4(b)(1)(iv). Further, as relevant here, original information "leads to" a successful enforcement action if either: (i) the original information caused the staff to open an investigation, and the Commission brought a successful action based in whole or in part on conduct that was the subject of the original information; or (ii) the conduct was already under investigation, and the original information significantly contributed to the success of the action. Rule 21F-4(c)(1)-(2), 17 C.F.R. § 240.21F-4(c)(1)-(2).

³ Rule 21F-10(e)(2) provides that a claimant seeking to contest a Preliminary Determination must submit a written response within 60 days that "set[s] forth the grounds for your objection to either the denial of an award or the proposed amount of an award." 17 C.F.R. § 240.21F-10(e).

Redacted

Any information #1 provided prior to July 21, 2010 is not "original information" under Rule 21F-4(b)(1)(iv) and therefore does not provide a basis for a whistleblower award. Indeed, #1 response to the Preliminary Determination fails to raise any explicit challenge to that rule.⁵

With regard to any information #1 submitted after Redacted such information Redacted Matter. Accordingly, #1 communications on Redacted did not lead to successful enforcement of the Redacted Matter.

As noted above, #1 asserts in #1 form WB-APP that #1 identified violations

Redacted

Even assuming that #1 did in fact share "original information" with the Redacted this would not entitle #1 to an award because it did not lead to the successful enforcement of the Redacted Matter.⁷ #1 has not provided any information to support the conclusion that #1 communicated anything Redacted that was reasonably related to the Redacted Matter. Moreover, Redacted confirmed that Redacted did not open an investigation into #1 allegations and had no connection to the Redacted Matter.

#1

Redacted

8

For all of these reasons, #1 claim is denied.

⁵ We recently rejected arguments by another whistleblower award claimant that Rule 21F-4(b)(1)(iv) was contrary to Dodd-Frank and impermissibly retroactive. See *In the Matter of the Claim for Award in connection with SEC v. Advanced Technologies Group Ltd., et al.*, 10-cv-4868 (S.D.N.Y. 2011), Notice of Covered Action 2011-4, Exchange Act Release No. 70772 (October 30, 2013).

⁶ To the extent that #1 repeated assertions made to the Enforcement staff prior to the enactment of Dodd-Frank concerning Redacted #1 Redacted #1 communication with Redacted did not satisfy the requirement of Rule 21F-4(b)(1)(iv) that "original information" be provided to the Commission "for the first time after July 21, 2010."

⁷ Further, #1 submission states that #1 ent Redacted Although the OWB has a general practice of taking reasonable steps to develop the record concerning a whistleblower's involvement in assisting Commission staff with investigations and litigation, the ultimate responsibility rests with an award claimant to specifically identify those correspondence or communications in which the purported "original information" was provided to the Commission. This is particularly important where, as here, the claimant does not identify many of the persons with whom #1 corresponded or provide copies of the correspondence. Thus, to the extent that #1 seeks to rely on any of these unspecified communications or correspondence, we deem #1 to have waived any argument that the information contained therein constituted original information. Notably, for persons submitting information after the effective date of the whistleblower rules, Rule 21F-2(a) requires that a whistleblower's original information must be submitted in accordance with the specified procedures in Rule 21F-9(a) – e.g., via a completed form TCR that is mailed or faxed to the Commission.

III. Claimant #2 Claim is Denied

Although award claims for the Notice of Covered Action Redacted were due no later than November 10, 2011, #2 submitted #1 WB-APP on Redacted

On Redacted the CRS made a Preliminary Determination recommending that #2 claim be denied. The Preliminary Determination concluded that the claimant did not submit a Form WB-APP for Notice of Covered Action Redacted within ninety (90) calendar days of the date of the respective Notice of Covered Action as required by Rule 21F-10(b) of the Exchange Act.

On Redacted #2 submitted a response contesting the Preliminary Determination pursuant to Rule 21F-10(e)(2) under the Exchange Act. In #2 response, #2 did not contest the fact that #2 Redacted WB-APP was untimely; instead, #2 asserted that the Commission lost an earlier filed, timely WB-APP.

We reject #2 contention that #2 filed an earlier, timely application. We believe that had #2 in fact filed an earlier claim, #2 would have at least cross-referenced it in #2 Redacted award claim; yet the Redacted award claim makes no reference whatsoever to an earlier filed claim. Indeed, not until after #2 received the CRS's Preliminary Determination denying #2 Redacted award claim as untimely did #2 first mention the alleged earlier filed application. At no point has #2 offered any evidence of this earlier filed application – neither a photocopy of it, a returned receipt, email correspondence regarding it, etc. Finally, an exhaustive review of our records reveals no such earlier filed award claim.

Further undercutting #2 contention is the fact that #2 has at no point offered an explanation for why, if #2 had in fact filed an earlier award application, #2 subsequently filed the Redacted application. We believe that a reasonable person under the circumstances that #2 alleges here would have offered an explanation for what motivated the filing of the second award application were that what actually occurred; the absence of an explanation from #2 throughout this proceeding thus, in our view, leads us to further doubt his version of events.

For these reasons, we reject #2 contention that #2 filed a timely award claim.⁹

⁹ In any event, we note that the information submitted by #2 to the Commission did not lead to the successful enforcement of the Redacted Matter because, as discussed above, Redacted

IV. Conclusion

Accordingly, upon due consideration under Rule 21F-10(h), 17 C.F.R. § 240.21F-10(h), it is hereby ORDERED that #1 and #2 whistleblower award claims are denied.

By the Commission.


Jill M. Peterson

Assistant Secretary

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

**Securities Act of 1933
Release No. 33-9569 / April 3, 2014**

**Securities Exchange Act of 1934
Release No. 34-71852 / April 3, 2014**

**ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR
2014 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002**

The Sarbanes-Oxley Act of 2002 (the "Act") provides that the Securities and Exchange Commission (the "Commission") may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard setting body that meets certain criteria. Consequently, Section 109 of the Act provides that all of the budget of such a standard setting body shall be payable from an annual accounting support fee assessed and collected against each issuer, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard setting body, and to provide for an independent, stable source of funding, subject to review by the Commission. Under Section 109(f) of the Act, the amount of fees collected for a fiscal year shall not exceed the "recoverable budget expenses" of the standard setting body. Section 109(h) amends Section 13(b)(2) of the Securities Exchange Act of 1934 to require issuers to pay the allocable share of a reasonable annual accounting support fee or fees, determined in accordance with Section 109 of the Act.

On April 25, 2003, the Commission issued a policy statement concluding that the Financial Accounting Standards Board ("FASB") and its parent organization, the Financial Accounting Foundation ("FAF"), satisfied the criteria for an accounting

standard-setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.¹ As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2014. In connection with its review, the Commission also reviewed the budget for the FAF and the FASB for calendar year 2014.

Section 109 of the Act also provides that the standard setting body can have additional sources of revenue for its activities, such as earnings from sales of publications, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual or perceived independence of the standard setter. In this regard, the Commission also considered the interrelation of the operating budgets of the FAF, the FASB, and the Governmental Accounting Standards Board ("GASB"), the FASB's sister organization, which sets accounting standards used by state and local government entities. The Commission has been advised by the FAF that neither the FAF, the FASB, nor the GASB accept contributions from the accounting profession.

The Commission understands that the Office of Management and Budget ("OMB") has determined the FASB's spending of the 2014 accounting support fee is sequestrable under the Budget Control Act of 2011.² So long as sequestration is applicable, we anticipate that the FAF will work with the Commission and Commission staff as appropriate regarding its implementation of sequestration.

¹ Financial Reporting Release No. 70.

² See "OMB Report Pursuant to the Sequestration Transparency Act of 2012" (P.L. 112-155), page 222 of 224 at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

After its review, the Commission determined that the 2014 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Act, that the FASB may act in accordance with this determination of the Commission.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71850 / April 3, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3808 / April 3, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15822

In the Matter of

TRANSAMERICA
FINANCIAL ADVISORS,
INC.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, AND SECTIONS 203(e) AND 203(k) OF
THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Transamerica Financial Advisors, Inc. ("TFA" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings contained in the Order, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the Investment Advisers Act

of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. Summary

1. TFA, a registered investment adviser and broker-dealer, failed to apply advisory fee discounts to certain retail clients in several of its advisory fee programs contrary to its disclosures to clients and its policies and procedures. During the relevant period, TFA offered clients in these programs breakpoint discounts that reduce the total advisory fee as the clients' assets in the programs increase. In various Form ADV Part 2 filings and in account opening documents, TFA represented that clients may request that TFA aggregate the values of certain related accounts to achieve these discounts. In addition, TFA's policies and procedures required that clients receive the savings from breakpoint discounts. Despite these disclosures, from January 2009 to June 30, 2013 (the relevant period), TFA failed, in certain instances, to apply the breakpoint discounts despite client requests for aggregation. TFA also failed to adopt and implement adequate policies and procedures to ensure that its clients' fees were calculated as represented. The Commission's examination staff first alerted TFA to certain of these problems in early 2010, but TFA failed to take adequate remedial steps. As a result, TFA improperly calculated advisory fees and thereby overcharged certain client accounts.

B. Respondent

2. TFA is a Delaware corporation based in St. Petersburg, Florida with branch offices throughout the United States. TFA is registered with the Commission as an investment adviser and a broker-dealer. TFA's advisory business has \$3.1 billion in regulatory assets under management held in approximately 22,500 client accounts according to its Form ADV filed in November 2013.

C. Facts

3. TFA, through its investment adviser representatives ("IARs"), offers retail clients several investment programs. These programs assist clients in allocating their assets among various investment products and offer differing management tools, research, and fees. Some programs, including the TFA Advantage Account Program ("Advantage Program"), TFA Capital Account Program ("Capital Program"), and TFA Sterling Advisory Account Program ("Sterling Program"), charge clients advisory fees that are assessed based on the amount of assets each client holds in their accounts. As of June 30, 2013, TFA had approximately 15,000 accounts in the

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Advantage Program, Capital Program, and Sterling Program with a total balance of approximately \$2.5 billion.

4. The total advisory fees for the Advantage Program, Capital Program, and Sterling Program have an administrative fee component. The administrative fee is an annual percentage of the assets under management in the clients' accounts. During the relevant period, TFA offered reductions or "breakpoints" in the administrative fee TFA charged to clients in its Advantage Program, Capital Program, and Sterling Program as their assets increased. The total advisory fee was negotiated by the IAR and the client and TFA's policies prohibited the total advisory fee, including the administrative fee, from exceeding 2.5%.

5. During the relevant period, TFA also offered Advantage Program, Capital Program, and Sterling Program clients the opportunity to aggregate certain related account balances for purposes of achieving the advisory fee breakpoints. For instance, TFA permitted clients in these programs to aggregate accounts held by "their spouses, domestic partners (as recognized by applicable state law), and children under the age of 21, whom reside with the clients."

6. TFA informed Capital Program and Sterling Program clients in certain account opening documents about the opportunity to aggregate certain account balances to qualify for a breakpoint discount in the advisory fee. For example, Capital Program and Sterling Program forms stated that aggregation allows the client "to pool the assets in all linked accounts for determining advisory fees." Beginning in May 2010, TFA stated in its Form ADV Part 2, which was made available to its clients, that Capital Program and Sterling Program clients had "the opportunity to aggregate account balances in related Program accounts . . . to allow account linkage for purposes of potential advisory fee reductions." Similarly, TFA had an internal policy of offering Advantage Program clients the opportunity to aggregate related account balances to qualify for breakpoint reductions.

7. To aggregate accounts, TFA required its clients to complete paperwork to request aggregation and identify the relevant accounts to be aggregated. TFA's procedures required that its IARs transmit the completed paperwork to the firm's headquarters in Florida. Employees at the firm's headquarters reviewed the paperwork and manually input the information into the billing system.

8. In 2009, the Commission's staff conducted an examination of a TFA branch office and in 2010 notified TFA that, among other things, it had not properly aggregated certain client accounts in the branch office. The examination staff identified several Capital Program clients in the branch office who had requested aggregation of related accounts, but did not receive breakpoint discounts. TFA represented to the Commission's examination staff that the aggregation failure occurred because of a miscommunication. According to TFA, the staff of that particular branch office mistakenly believed that TFA's headquarters was automatically aggregating the accounts without the direction of the IARs. As a result, the branch office failed to notify the appropriate staff at TFA's headquarters which accounts should be aggregated or whether certain clients had requested account aggregation.

9. The examination staff noted that TFA may not be aggregating accounts on a systematic basis and recommended that TFA review all investment advisory accounts for all branches to ensure that TFA was properly applying breakpoint discounts. Although TFA provided refunds to clients in the particular branch office under examination, and despite the examination staff's recommendation, TFA did not undertake a review of all of its branches.

10. As a result of the 2009 examination, TFA took several steps to notify both its clients and IARs of the existence and mechanics of the account aggregation process for the purpose of fee breakpoints. First, TFA issued a firm-wide compliance alert in June 2010 reminding its IARs to inform clients of the benefits of aggregation and the possible advisory fee reductions. The alert also stated that the IAR was responsible for notifying TFA headquarters if the client wished to aggregate its account balances. Second, TFA modified its account opening documentation for the Capital Program and Sterling Program to more clearly document whether a client wished to aggregate related accounts. If a client declined to aggregate, TFA required the client to write the reasons for the non-aggregation on the form. Third, TFA modified its policies and procedures to require its IARs to confirm that non-aggregating clients had provided written explanations for any non-aggregation. The firm also modified its policies and procedures to state that if a client selects aggregation, the IAR was "*required* to reduce the advisory fees through the advisory fee reduction schedule." (Emphasis added.) Fourth, TFA committed to including a one-time mailing insert in its quarterly statements to apprise its clients of its account aggregation policy and the need for clients to notify their IARs of accounts that should be aggregated.

11. TFA also added disclosures to its Form ADV Part 2 filed on May 28, 2010, indicating that Capital Program and Sterling Program clients may aggregate account balances in related accounts to receive potential fee reductions. TFA reiterated the availability of this discount in its Forms ADV Part 2 filed on June 15, 2011, January 13, 2012, and May 31, 2012.

12. In February 2012, the Commission's staff conducted a subsequent firm-wide examination of TFA and found that in certain instances the aggregation issues identified in the previous branch office examination existed nationwide and were ongoing. Most significantly, the staff found that, despite its new account opening documentation created in response to the staff's 2009 branch office examination, TFA was still failing to aggregate certain accounts for clients in the Capital Program and was similarly failing to aggregate the related accounts of certain clients in the Sterling Program. TFA also acknowledged to the Commission's staff that similar problems occurred with Advantage Program clients.

13. The failures occurred because of inadequate policies and procedures at TFA's headquarters to implement the breakpoints policy. TFA has two teams involved in establishing new accounts—the New Business Team and the Suitability Review Team—but the firm's policies and procedures did not clearly delineate which team was responsible for reviewing new account forms for account aggregation purposes. As a result, TFA did not review many new account forms for aggregation purposes and, therefore, failed in certain instances to appropriately link accounts together to apply breakpoints in the billing process.

14. The Commission's staff also discovered that while TFA had prepared the one-time mailing insert designed to apprise its clients of its aggregation policy and the need for clients to notify their IARs of accounts that should be aggregated, TFA failed to ensure that the information was disseminated to clients. Specifically, TFA's third-party mailing service, which was responsible for mailing the insert, never sent it to TFA clients.

15. Despite the 2009 branch office examination findings, TFA failed to implement policies and procedures reasonably designed to ensure that it calculated clients' fees in a manner consistent with its disclosure to clients. First, TFA's policies and procedures require that its IARs ensure that a client's reasons for not wanting aggregation are documented. This policy addressed a significant deficiency at TFA in light of the aggregation issues identified by the Commission examination staff in 2009. However, many Capital Program and Sterling Program account forms prepared subsequent to the 2009 branch office examination did not include an explanation as to why particular clients with multiple accounts had chosen not to aggregate their accounts.

16. Second, TFA failed to adopt and implement adequate policies and procedures reasonably designed to ensure that its IARs reduced advisory fees when clients opted to aggregate accounts in the Advantage Program, Capital Program, and Sterling Program as required by the firm beginning in June 2010. TFA issued a firm-wide compliance alert to its IARs in June 2010 notifying them that if a client selected aggregation, the IAR was required to reduce the total fees through the advisory fee schedule. Nevertheless, even after June 2010, some clients in the three programs had requested aggregation, but did not receive the discounts because the IAR set the total advisory fees at each breakpoint in a manner that negated the benefit from the reduction in administrative fees.

17. In addition to these failures, TFA's policies and procedures regarding the fee breakpoints were not reasonably designed in one other respect. TFA maintained two policy and procedure manuals: a Registered Investment Adviser Manual ("RIA Manual") and an Investment Adviser Representative Manual ("IAR Manual"). These manuals contained conflicting policies on the application of advisory fee breakpoints. The RIA manual stated that if a client selects aggregation, the IAR was "*required* to reduce the advisory fees through the advisory fee reduction schedule." (Emphasis added.) However, the IAR Manual appeared to give IARs discretion on whether to pass on the breakpoint fee reductions. The IAR Manual stated that the IAR "*may* reduce the advisory fees through the advisory fee reduction schedule." (Emphasis added.) Thus, the IAR Manual conflicted with both the RIA Manual and the firm's June 2010 compliance alert to its IARs, which also required that "IAR[s] reduce the advisory fees through the advisory fee schedule."

D. Violations

18. As a result of the conduct described above, TFA willfully² violated Section 206(2) of the Advisers Act which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client. Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act but, rather, may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

19. As a result of the representations regarding account aggregation TFA made in Part II of TFA's Forms ADV filed with the Commission in 2010, 2011, and 2012, TFA willfully violated Section 207 of the Advisers Act which makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.³

20. TFA also willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder, which requires that an investment adviser adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons.

E. Remedial Efforts

21. Subsequent to the Commission staff's second examination and enforcement investigation, TFA initiated a firm-wide review of client accounts in the Advantage Program, Capital Program, and Sterling Program. In consultation with the Enforcement staff, TFA reviewed the records of current and former clients who may have paid excess fees and provided them with refunds and credits plus interest. TFA also sent letters notifying 22,091 clients and former clients that, in connection with an SEC regulatory examination, the firm was conducting an in-depth review of any related advisory accounts that may not have been aggregated properly for purposes of advisory fee discounts. As a result of these efforts, TFA has provided refunds and credits to 2,304 accounts of clients and former clients who were overcharged fees. The refunds and credits totaled \$553,624.32, including interest. In determining to accept the Offer, the Commission considered the remedial acts promptly undertaken by TFA and the cooperation TFA afforded the Commission staff.

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

³ Prior to October 2010, Rule 204-1(c) under the Advisers Act provided that Part II of Form ADV was considered filed with the Commission if the adviser maintained a copy in its files. *See* IA Rel. No. 3060 (August 12, 2010).

F. Undertakings

Respondent has undertaken to:

22. Independent Compliance Consultant. With respect to the retention of an independent compliance consultant, TFA has agreed to the following undertakings:

a. TFA has retained the services of an independent compliance consultant (the "Independent Consultant") that is not unacceptable to the Commission staff. The Independent Consultant's compensation and expenses shall be borne exclusively by TFA. Prior to the retention of the Independent Consultant, TFA has provided to the staff of the Commission a copy of an engagement letter detailing the Independent Consultant's responsibilities, which includes the reviews to be made by the Independent Consultant as described in this Order.

b. TFA shall require that the Independent Consultant conduct a review of TFA's policies and procedures required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and pertaining to its account opening forms for its investment programs, advisory fee schedules, advisory fee computation methodologies, and account aggregation process for breakpoints.

c. Within thirty (30) days after the entry of this Order, the Independent Consultant shall submit a written and dated report of its findings to TFA and to the Commission staff (the "Report"). TFA shall require that each Report include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to TFA's policies and procedures and/or disclosures to clients, and a procedure for implementing the recommended changes in or improvements to TFA's policies and procedures and/or disclosures.

d. TFA shall adopt all recommendations contained in the Report within sixty (60) days of the Report; provided, however, that within thirty (30) days after the date of the Report, TFA shall in writing advise the Independent Consultant and the Commission staff of any recommendations that TFA considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that TFA considers unduly burdensome, impractical, or inappropriate, TFA need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose.

e. As to any recommendation with respect to TFA's policies and procedures on which TFA and the Independent Consultant do not agree, TFA and the Independent Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by TFA and the Independent Consultant, TFA shall

require that the Independent Consultant inform TFA and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that TFA considers to be unduly burdensome, impractical, or inappropriate. TFA shall abide by the determinations of the Independent Consultant and, within thirty (30) days after final agreement between TFA and the Independent Consultant or final determination by the Independent Consultant, whichever occurs first, TFA shall adopt and implement all of the recommendations that the Independent Consultant deems appropriate.

f. Within thirty (30) days of TFA's adoption of all of the recommendations in the Report that the Independent Consultant deems appropriate, as determined pursuant to the procedures set forth herein, TFA shall certify in writing to the Independent Consultant and the Commission staff that TFA has adopted and implemented all of the Independent Consultant's recommendations in the Report. Thereafter, beginning one hundred eighty days (180) after the entry of this Order, the Independent Consultant shall conduct such review as it deems appropriate to verify that TFA has appropriately implemented the recommendations in the Report. Prior to two hundred and ten (210) days after the entry of this Order, the Independent Consultant shall confirm to the Commission staff that TFA has adopted and implemented all of the Independent Consultant's recommendations in the Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131, or such other address as the Commission staff may provide.

g. TFA shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of its files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.

h. To ensure the independence of the Independent Consultant, TFA: (1) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant without the prior written approval of the Commission staff; and (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

i. TFA shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with TFA, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist

the Independent Consultant in the performance of the Independent Consultant's duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with TFA, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

23. Recordkeeping. TFA shall preserve for a period of not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of its compliance with the undertakings set forth herein.

24. Notice to Advisory Clients. Within ten (10) days of the entry of this Order, TFA shall post prominently on its principal website a summary of this Order in a form and location acceptable to the Commission staff, with a hyperlink to the entire Order. TFA shall maintain the posting and hyperlink on TFA's website for a period of twelve (12) months from the entry of this Order. Within thirty (30) days of the entry of this Order, TFA shall send a letter in a form acceptable to the Commission staff to all current Advantage Program, Capital Program, and Sterling Program clients notifying them of the entry of this Order via mail, e-mail, or such other method. If sent electronically, the letter shall contain a hyperlink to the Order and, if sent by mail, the Order shall be attached. Furthermore, for a period of twelve (12) months from the entry of this Order, to the extent that TFA is required to deliver a brochure to a client and/or prospective client pursuant to Rule 204-3 of the Advisers Act, the brochure shall provide notice of the entry of this Order, contain a URL where the Order can be viewed, and provide the client or prospective client the opportunity to request a copy of the Order. Within fourteen (14) days of such a request, TFA shall deliver a copy of the Order to the client or prospective client.

25. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

26. Certifications of Compliance by Respondents. TFA shall certify, in writing, compliance with its undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and TFA agrees to provide such evidence. The certification and supporting material shall be submitted to Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. TFA cease and desist from committing or causing any violations and any future violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. TFA is censured.

C. TFA shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$553,624 to the Securities and Exchange Commission. The Commission is not ordering TFA to pay disgorgement due to the full reimbursement that TFA provided to its clients during the Commission staff's investigation. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying TFA as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Chad Alan Earnst, Assistant Regional Director, Division of Enforcement, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

D. TFA shall comply with the undertakings enumerated in Paragraphs 22 to 26 of this Order.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, TFA agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of

compensatory damages by the amount of any part of TFA's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, TFA agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against TFA by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9571 / April 3, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71864 / April 3, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31005 / April 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of
DONALD J. ANTHONY, JR.,
FRANK H. CHIAPPONE,
RICHARD D. FELDMANN,
WILLIAM P. GAMELLO,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER,
PHILIP S. RABINOVICH, and
RYAN C. ROGERS,

Respondents.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER PURSUANT
TO SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940 AS TO RICHARD
D. FELDMANN

I.

On September 23, 2013, the Securities and Exchange Commission ("Commission") deeming it appropriate and in the public interest, instituted these public administrative and cease and desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Richard D. Feldmann ("Feldmann" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings

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brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order, as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Respondent

1. **Richard D. Feldmann**, 74 years old, is a resident of Delmar, NY. He was registered with MS & Co. from July 1987 to December 2009.

Other Relevant Entities and Individuals

2. **McGinn, Smith & Co., Inc. ("MS & Co.")**, a New York corporation founded in 1980 by David Smith and Timothy McGinn, had its principal place of business at 99 Pine Street, Albany, NY, and maintained branch offices at Clifton Park, NY, New York, NY, and King of Prussia, PA. MS & Co. was registered with the Commission as a broker-dealer beginning in 1980 and as an investment adviser in April 2009. It was owned by David Smith (50%), Timothy McGinn (50%; 30% after 2004), and Thomas Livingston (20% after 2004). From 2003 to 2009, MS & Co. had about 55 employees, including about 35 registered representatives. On December 24, 2009, MS & Co. filed a partial BD-W. On March 9, 2010, MS & Co. also withdrew its investment adviser registration. FINRA terminated MS & Co.'s FINRA membership on August 4, 2010.

3. The **Four Funds** were New York limited liability companies, whose sole managing member was MS Advisors, an investment adviser owned by Smith (50%), McGinn (30%) and Livingston (20%) that was registered with the Commission from January 3, 2006 to April 24, 2009. MS & Co. served as the placement agent for the Four Funds offerings, and McGinn, Smith Capital Holdings Corp. ("MS Capital") acted as the Trustee. The Four Funds shared offices with MS & Co. and the other McGinn Smith entities at 99 Pine Street, Albany, NY. The Four Funds offerings are listed below, along with the promised rate of return, the maximum amount of the offering, and the date of the PPM:

- (a) First Independent Income Notes, LLC ("FIIN"), 5%/7.5%/10.25% (\$20 million) (9/15/03);
- (b) First Excelsior Income Notes LLC ("FEIN"), 5%/7.5%/10.25% (\$20 million) (1/16/04);
- (c) Third Albany Income Notes, LLC ("TAIN"), 5.75%/7.75%/10.25% (\$30 million) (11/1/04); and

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

- (d) First Advisory Income Notes, LLC ("FAIN"), 6%/7.75%/10.25% (\$20 million) (10/1/05).

4. The **Trust Offerings** were offerings by special purpose entities, purportedly to invest in contracts for burglar alarm service, "triple play" (broadband, cable and telephone) service or luxury cruises. MS & Co. acted as a placement agent and MS Capital acted as Trustee for the Trust Offerings. The Trust Offerings are listed below, along with the promised rate of return, the maximum amount of the offering, and the date of the PPM:

- (a) TDM Cable Trust 06, 7.75%/9.25% (\$3,550,000) (11/13/06)
- (b) TDM Verifier Trust 07, 8.25%/9% (\$3,475,000) (2/23/07)
- (c) Firstline Senior Trust 07, 9.25% (\$1,850,000) (5/19/07)
- (d) Firstline Trust 07, 11% (\$1,867,000) (5/19/07)
- (e) Firstline Senior Trust 07 Series B, 9.5% (\$1,435,000) (10/19/07)
- (f) TDM Luxury Cruise Trust 07, 10% (\$3,630,000) (7/16/07)
- (g) Firstline Trust 07 Series B, 11% (\$2,115,000) (10/19/07)
- (h) TDM Verifier Trust 08, 8.50%/10% (\$3,850,000) (12/17/07)
- (i) Cruise Charter Ventures Trust 08, 13% (\$3,250,000) (2/14/08)
- (j) Integrated Excellence Sr. Trust 08, 9% (\$900,000) (5/30/08)
- (k) Integrated Excellence Jr. Trust 08, 10% (\$580,000) (5/30/08)
- (l) Fortress Trust 08, 13% (\$3,060,000) (9/24/08)
- (m) TDM Cable Trust 06, 10% (\$1,380,000) (11/17/08)
- (n) TDM Verifier Trust 09, 10% (\$1,300,000) (12/15/08)
- (o) TDMM Cable Jr Trust 09, 11% (\$1,325,000) (1/19/09)
- (p) TDMM Cable Sr. Trust 09, 9% (\$1,550,000) (1/19/09)
- (q) TDM Verifier Trust 07R, 9% (\$2,100,000) (2/2/09)
- (r) TDM Verifier Trust 08R, 9% (\$2,005,000) (7/6/09)
- (s) TDMM Benchmark Trust 09, 8%, 9%, 10%, 11%, 12% (\$3,000,000) (8/20/09)
- (t) TDM Verifier Trust 11, 9% (\$1,550,000) (9/3/09)
- (u) Cruise Charter Ventures, LLC, 12% (\$400,000) (9/25/09)

5. **McGinn Smith Transaction Funding ("MSTF")** was a New York corporation formed in 2008. Like the Four Funds and Trust offerings, the \$10 million MSTF offering on April 22, 2008 was underwritten by MS & Co.

6. **Timothy M. McGinn**, 64 years old, was the chairman, secretary and co-owner of MS & Co. From July 2003 through May 2006, McGinn served as CEO of Integrated Alarm Services Group, Inc. ("IASG"), which went public in July 2003. In September 2011, FINRA permanently barred McGinn from associating with any FINRA member. On February 6, 2013, following a four-week trial, a jury in the Northern District of New York found McGinn guilty of multiple counts of mail and wire fraud, securities fraud, and filing false tax returns. *United States v. Timothy M. McGinn & David L. Smith*, 12-CR-28 (DNH) (N.D.N.Y.). On August 7, 2013, McGinn was sentenced to 15 years in prison and ordered to pay restitution of \$5,992,800.

7. **David L. Smith**, 67 years old, was the president and chief executive officer of MS & Co. and the manager of the Four Funds. Until 2007, Smith was also the chief compliance officer of MS & Co. In September 2011, FINRA permanently barred Smith from associating with any FINRA member. On February 6, 2013, following a four-week trial, a jury in the Northern District

of New York found Smith guilty of multiple counts of mail and wire fraud, securities fraud, and filing false tax returns. *United States v. Timothy M. McGinn & David L. Smith*, 12-CR-28 (DNH) (N.D.N.Y.). On August 7, 2013, Smith was sentenced to 10 years in prison and ordered to pay restitution of \$5,989,736.

Summary

8. From late 2003 through 2009, David Smith and Timothy McGinn, using issuers that they created, owned and controlled, orchestrated two dozen fraudulent offerings in which hundreds of notes were marketed, offered, and sold by brokers associated with their registered broker-dealer, MS & Co. The offerings raised more than \$125 million from more than 800 investors; investor losses exceed \$80 million.

9. Feldmann was among the top selling brokers during the relevant time period, and Feldmann's customers suffered significant losses. Feldmann offered and sold notes to accredited and unaccredited investors alike for which no registration statements were in effect, and no exemptions applied.

10. In addition, Feldmann knowingly or recklessly: (a) failed to perform adequate due diligence to form a reasonable basis for his recommendations to customers and ignored a number of red flags concerning the offerings; and (b) made misrepresentations and omissions in selling the fraudulent note offerings to investors from 2003 to 2009.

Background

11. The Four Funds offerings raised at least \$85 million. Although the Four Funds PPMs labeled each tranche as "secured," there were no secured assets subject to forfeiture in the event that a particular Fund failed.

12. According to the PPMs, MS & Co., as the placement agent, was to receive a commission of 2% of the offering proceeds. In addition, according to the PPMs, the brokers were entitled to (and did receive) "incentive commissions . . . [paid] to our managing member's salesmen at the rate of 2% of the aggregate principal amount of the notes per year over the term of the notes."

13. Smith had no experience in making investment decisions and managing investments for entities like the Four Funds, and Smith had broad flexibility in making investment decisions.

14. The PPMs stated that the notes would be offered only to accredited investors, as defined in Rule 501(a) of Regulation D. Despite these representations, each of the Four Funds offerings had more than 35 unaccredited investors. Feldmann sold each of the Four Funds to unaccredited investors.

15. In September 2003, just weeks after the launch of the FIIN offering, Smith began diverting millions of dollars to pay investors in pre-2003 MS & Co. offerings. Overall, Smith used

at least \$12.8 million of the Four Funds offering proceeds to pay investors in pre-2003 MS & Co. offerings.

16. Smith invested a majority of the Four Funds' proceeds in entities that were affiliated with MS & Co., even though the PPM did not disclose this, and in risky and highly speculative venture capital investments. The Four Funds' investments did not generate sufficient returns required to meet the issuers' obligations to investors.

17. In 2006, McGinn returned to MS & Co. on a full-time basis after nearly three years as CEO of IASG. McGinn created the twenty-one Trust Offerings, plus MSTF, that raised over \$41 million. The Trust Offerings ostensibly were created to fund entities engaged in specific areas, such as burglar alarm service, triple play service, or luxury cruises. These entities, however, were not funded directly by the issuer; instead, in most cases, the offering proceeds were first transferred to various conduit entities, primarily McGinn Smith Funding LLC (the "MSF Conduit") or TDM Cable Funding LLC (the "TDM Conduit"). The proceeds of the Trust Offerings were commingled and then used as needed by MS & Co., including infusing cash into the faltering Four Funds.

18. The Trust PPMs stated that they would "generally be offered only to accredited investors," but also provided for 35 or fewer unaccredited investors, supposedly under Rule 506. When integrated according to their Conduit entity, Rule 506's limitation on unaccredited investors was breached: more than 35 investors in the Trusts tied to the TDM Conduit were unaccredited, and more than 35 investors in the Trusts linked to the MSF Conduit were unaccredited.

19. The Trust Offerings continued the egregious misuse of investor funds. Smith and McGinn, for example, took for personal use millions of dollars in offering proceeds from the TDM Cable 06, TDMM Cable, Integrated Excellence, MSTF and Fortress offerings, used investor funds to pay earlier noteholders, and used the Trust Offering proceeds to satisfy liquidity needs for other MS & Co. entities.

Feldmann's Unlawful Conduct

20. Feldmann sold approximately \$5.4 million of the Four Funds offerings and approximately \$595,000 of the Trust Offerings, through which Feldmann earned approximately \$299,000 in commissions.

21. Feldmann failed to conduct adequate due diligence. In addition, numerous red flags should have alerted Feldmann to the need for further investigation, but he continued to sell the private placements Smith and McGinn told him to sell.

22. Feldmann also made material misrepresentations and omissions when recommending the Four Funds and Trust Offerings to his customers.

Respondent Failed to Have a Reasonable Basis to Recommend the Four Funds Offerings.

23. Feldmann performed inadequate due diligence prior to recommending the Four Funds to his customers. The PPMs for the Four Funds, which he read or was reckless in not

reading, made disclosures that should have caused Respondent, as an associated person of a broker-dealer, to conduct a searching inquiry prior to recommending the products to his customers. This heightened duty arose from the following factors:

- a. The PPMs made clear that Smith owned and controlled each of the issuers – which were new, single-purpose entities with no operating history – as well as the placement agent (MS & Co.) and the trustee. Smith also had total control over the disposition of investor funds, with absolutely no oversight or control. As a result, Respondent should have made specific inquiries as to how customer money would be invested before recommending the Four Funds to his customers.
- b. Respondent knew or should have known that Smith had never before managed offerings of the size and scope of the Four Funds. The debt offerings that MS & Co. had done before 2003 were small-scale note offerings tied to the income streams from home alarm contracts, far different from the broad and non-specific investment mandate of Four Funds offerings. Given Smith's lack of experience in this area, and Feldmann's knowledge of this lack of experience, he should have made specific inquiries as to how Smith planned to invest the offering proceeds. This is particularly true given fact that the issuers' ability to make the relatively high interest payments, and to return the investors' principal, depended on the nature of the investments;
- c. The PPMs stated that the Four Funds could acquire investments "from our managing member [MS Advisors] or any affiliate," could "purchase securities from issuers in offerings for which [MS & Co.] is acting as underwriter or placement agent," and that "[a]ffiliates of the placement agent may purchase a portion of the notes offered hereby." As a result, Respondent should have inquired whether Smith—who controlled without oversight the issuers, the placement agent and the disposition of investor funds—did engage in any transactions with affiliates. If he had, Respondent would have discovered that nearly half of the offering proceeds had been invested in affiliates; and
- d. The Four Funds PPMs prohibited sales to any unaccredited investors. Nevertheless, Respondent knew that sales were being made to unaccredited investors and knew, or should have known, therefore, that the PPMs' prohibition on sales to unaccredited investors was disregarded.

24. These factors should have prompted Feldmann to conduct a searching inquiry into the offerings. Instead, Respondent sold the Four Funds offerings without taking adequate steps to obtain information about how investor funds were being used.

Smith's Refusal to Disclose to the Brokers How He Had Invested Four Funds Offering Proceeds Was a Red Flag.

25. From the commencement of the FIIN offering in September 2003 until January 2008, Smith provided his brokers with no specific information about how he had invested the offering proceeds. Any questions by the brokers were deflected with the claim that Smith had made loans to local Albany businesses with Four Funds proceeds, and those businesses desired anonymity. Indeed, Smith steadfastly refused to give the brokers any meaningful information about how he had invested the Four Funds offering proceeds. This refusal should have prompted Feldmann to further question the propriety of the Four Funds.

26. The information blackout that Smith imposed was contrary to the PPMs, which stated that an "annual statement of the operations consisting of a balance sheet and income statement" would be provided to investors upon request. These reports, however, were never made available and it appears that Respondent never requested this information before January 2008, when Smith disclosed that the Four Funds would be restructured.

27. MS & Co.'s compliance manual, moreover, stated that "it will make a reasonable investigation . . . [and] Paperwork recording the due diligence will be kept in the legal files." Nevertheless, Feldmann never asked to see the due diligence files.

Respondent Continued to Recommend MS & Co. Offerings Despite Knowledge of the Redemption Policy – Another Major Red Flag.

28. By 2006, the Funds began having significant difficulty in meeting the redemption requests. Smith therefore instituted a policy that required brokers to "replace" customers seeking to redeem Four Funds notes, including maturing notes, with new customers (the "Redemption Policy"). The PPMs, however, did not state that a customer's right to redemption depended on finding a "replacement."

29. Feldmann learned of the Redemption Policy by November 2007. The Redemption Policy was another red flag, but Respondent nevertheless failed to disclose the Redemption Policy to his customers.

Respondent Continued to Sell the Trust Offerings Despite Learning in January 2008 that the Four Funds Had Been Mismanaged.

30. On January 8, 2008, Smith and McGinn held an all-day meeting to inform the brokers, including Respondent, that the Four Funds were in default, that payments to investors would be curtailed, and that the offerings would be restructured. Smith revealed that the Four Funds investment portfolios consisted of loans to small, local businesses, some of which had already filed for bankruptcy; risky venture capital investments; investments with sub-prime exposure; and other nonperforming investments. By contrast, the Four Funds each had made only one investment in a publicly-traded security: Exchange Boulevard.com, a risky venture capital company that was quoted on OTC Link, formerly known as the Pink Sheets.

31. Respondent, despite the significant disclosures in this meeting, did not request or conduct any kind of probing investigation into what happened to the Four Funds or the ongoing Trust Offerings. After the January 2008 meeting, there were thirteen offerings by MSTF and the Trusts, which raised at least \$20 million. As a result of the accumulation of red flags since the launch of the Four Funds in September 2003, Respondent should have conducted a searching inquiry regarding any MS & Co. private placement. Instead, he recommended the Trust Offerings to his customers based on insufficient due diligence and failed to disclose to investors the risky nature of the Trust Offerings or the facts that should have led Feldmann to that conclusion.

32. During the three years of the Trust and MSTF Offerings, investor funds were being used in ways contrary to the uses described in the PPMs; for example, Smith and McGinn took at least \$4 million in offering proceeds for themselves and another MS & Co. officer. Offering proceeds also were used to pay investors in earlier offerings and MS & Co.'s payroll. And the amount actually invested pursuant to particular Trust Offering PPMs was far less than that PPM disclosed. None of these facts led Feldmann to engage in the kind of searching inquiry the circumstances demanded.

Violations

33. As a result of the conduct described above, Feldmann willfully violated Sections 5(a) and (c) of the Securities Act, which prohibit the sale of unregistered securities absent exemptions not present here.

34. As a result of the conduct described above, Feldmann willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities, and in connection with the purchase or sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Feldmann's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Feldmann cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

B. Respondent Feldmann be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of \$299,000 and prejudgment interest of \$55,384.87 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent shall, within 14 days of the entry of this Order, also pay a civil money penalty in the amount of \$130,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Feldmann as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to David Stoelting, Esq., Division of Enforcement,

Securities and Exchange Commission, 200 Vesey Street, Suite 400, Brookfield Place, New York, NY 10281.

E. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.


Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 270

[Release Nos. 33-9570; 34-71861; IC-31004; File No. S7-12-10]

RIN 3235-AK50

Investment Company Advertising: Target Date Retirement Fund Names and Marketing

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; request for additional comment.

SUMMARY: The Securities and Exchange Commission ("Commission") is reopening the period for public comment on rule amendments it proposed in 2010, Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9126 (June 16, 2010), 75 FR 35920. Among other things, the proposed amendments would, if adopted, require marketing materials for target date retirement funds ("target date funds") to include a table, chart, or graph depicting the fund's asset allocation over time, *i.e.*, an illustration of the fund's so-called "asset allocation glide path." In 2013, the Commission's Investor Advisory Committee ("Committee") recommended that the Commission develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as a replacement for, or supplement to, the proposed asset allocation glide path illustration. The Commission is reopening the comment period to seek public comment on this recommendation.

DATES: Comments should be received on or before **[insert date 60 days after publication in the Federal Register]**.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form

to investors concerning target date funds and reduce the potential for investors to be confused or misled regarding these funds.¹ In particular, the Commission is requesting comment on the recommendations of the Committee relating to the development of a risk-based glide path illustration.

I. BACKGROUND

A target date fund is designed to make it easier for investors to hold a diversified portfolio of assets that is rebalanced automatically among asset classes over time without the need for each investor to rebalance his or her own portfolio repeatedly, and is typically intended for investors whose retirement date is at or about the fund's stated target date. Target date funds generally invest in a diverse mix of asset classes, including stocks, bonds, and cash and cash equivalents (such as money market instruments). As the target date approaches and often continuing for a significant period thereafter, a target date fund shifts its asset allocation in a manner that generally is intended to become more conservative—usually by decreasing the percentage allocated to stocks. Target date funds have become more prevalent in 401(k) plans as a result of the designation of these funds as a qualified default investment alternative by the Department of Labor pursuant to the Pension Protection Act of 2006.² In 2013, assets of target

¹ Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9126 (June 16, 2010) [75 FR 35920 (June 23, 2010)] ("Proposing Release").

² See Default Investment Alternatives Under Participant Directed Individual Account Plans, 72 FR 60452, 60452–53 (Oct. 24, 2007).

in light of empirical research undertaken by a consultant on the Commission's behalf relating to individual investors' understanding of target date funds.⁹

In April 2013, the Investor Advisory Committee¹⁰ recommended, among other things, that the Commission develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, the proposed asset allocation glide path illustration. The Committee also recommended that the Commission adopt a standard methodology or methodologies to be used in the risk-based glide path illustration.¹¹ The Committee stated that much of the differences in risk among target date funds can be explained by differences in asset allocation models and glide paths, but that choices of assets within the various asset classes and other risk management practices can also have a significant impact on fund risk levels. The Committee also stated that asset allocation may mask significant differences in the risk levels of funds with apparently similar or even identical asset

⁹ Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9309 (Apr. 3, 2012) [77 FR 20749 (Apr. 6, 2012)].

¹⁰ Section 911 of the Dodd-Frank Wall Street Reform and Consumer Protection Act added section 39 to the Securities Exchange Act of 1934, which establishes the Investor Advisory Committee. The Committee advises and consults with the Commission on regulatory priorities, issues, and initiatives and submits findings and recommendations to the Commission. 15 U.S.C. 78pp(a). The Commission reviews the findings and recommendations of the Committee and determines what action, if any, to take. 15 U.S.C. 78pp(g).

¹¹ Recommendation of the Investor Advisory Committee: Target Date Mutual Funds (Apr. 11, 2013), available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-target-date-fund.pdf>. The Committee also recommended that the Commission (i) adopt a standard methodology or methodologies to be used in the asset allocation glide path illustration; (ii) require target date fund prospectuses to disclose and clearly explain the policies and assumptions used to design and manage the target date offerings to attain the target risk level over the life of the fund; (iii) consider testing various approaches to providing disclosure that a target date fund is not guaranteed in order to determine the most effective approach and then mandate that approach; and (iv) amend the fee disclosure requirements for target date funds to provide better information about the likely impact of fund fees on total accumulations over the expected holding period of the investment. *Id.*

reflect.¹³ We also sought comment on whether the rule should require disclosure of a risk rating based on a scale or index that could be compared to other target date funds.¹⁴

The comments that we received on this issue, however, were limited. Some commenters suggested alternative approaches to the glide path illustration that would require a risk-based illustration, rather than an illustration of the fund's changing investments in asset classes over time. For example, commenters recommended that we require: (i) portfolio risk-related information, data, or graphs along with asset allocation information;¹⁵ (ii) the planned risk level in the glide path disclosure, for example, by presenting the planned standard deviation of returns over the life of the fund;¹⁶ (iii) a color- and number-coded risk spectrum showing a fund's position relative to an appropriate target date fund index;¹⁷ or (iv) whether the fund reflects aggressive, moderate, or conservative risk characteristics, based on certain benchmarks.¹⁸ Another commenter expressed skepticism about the feasibility of establishing a standardized risk rating for target date funds, and stated that developing such a rating would be "an enormous undertaking with questionable benefit that is significantly beyond the scope" of the rulemaking.¹⁹

¹³ *Id.* at 35927 ("Would a fund manager's investment strategy, portfolio construction, selection of asset categories disclosed, and marketing change as a result of the proposal's required disclosure of target date (or current) asset allocation? For example, might fund managers compose the fund's fixed-income allocation differently to take on additional investment risk, in order to seek higher returns, while showing a lower equity allocation at or after the target date?").

¹⁴ *Id.* at 35928.

¹⁵ See Comment Letter of Chao & Company, Ltd. (July 6, 2012).

¹⁶ See Comment Letter of Foliofn Investments Inc. (Mar. 28, 2011); Comment Letter of Foliofn Investments Inc. (May 21, 2012).

¹⁷ See Comment Letter of Wells Fargo (May 21, 2012).

¹⁸ See Comment Letter of SST Benefits Consulting (Apr. 9, 2012).

¹⁹ See Comment Letter of the Investment Company Institute (Aug. 23, 2010).

the basis for a target date fund risk-based glide path illustration.²⁰ We note that there are a variety of quantitative measures of risk used in the financial services industry. Some target date funds already provide quantitative risk measures in certain materials on a historical basis.²¹ For example, the risk associated with a portfolio can be captured by the variability of its returns, measured by the standard deviation²² (or volatility) or semi-variance of those returns.²³ Both of these risk measures are “total risk measures” that quantify the total variability of a portfolio’s

²⁰ In 1995, the Commission issued a release requesting comment on how to improve risk disclosure for investment companies, including ways to increase the comparability of fund risk levels. Improving Descriptions of Risk by Mutual Funds and Other Investment Companies, Investment Company Act Release No. 20974 (Mar. 29, 1995) [60 FR 17172 (Apr. 4, 1995)] (“Risk Concept Release”). In particular, the Risk Concept Release requested comment on whether quantitative risk measures—such as standard deviation, beta, and duration—would help investors evaluate and compare fund risks. We received over 3,700 comment letters, mostly from individual investors. Commenters confirmed the importance of risk disclosure to investors when evaluating and comparing funds and highlighted the need to improve risk disclosures in fund prospectuses. Although more than half of the individual commenters and some industry members expressed a desire for some form of quantitative risk information, commenters did not broadly support any one risk measure, and the Commission acknowledged that investors have a wide range of ideas of what “risk” means. See Registration Form Used by Open-End Management Investment Companies, Investment Company Release No. 23064 (Mar. 13, 1998) [63 FR 13916, 13929 (Mar. 23, 1998)] (“Registration Form Adopting Release”). In 1997, the Commission proposed a requirement that a fund’s prospectus include a bar chart showing the fund’s annual returns for 10 calendar years, noting that over 75% of individual investors responding to the Risk Concept Release favored a bar chart presentation of fund risks. See Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 22528 (Feb. 27, 1997) [62 FR 10898, 10904 (Mar. 10, 1997)]. The Commission subsequently adopted the bar chart requirement, which was intended to illustrate graphically the variability of a fund’s returns and thus provide investors with some idea of the risk of an investment in the fund. See Registration Form Adopting Release, at 13922.

²¹ Based on a staff review of target date fund marketing materials.

²² See, e.g., *Morningstar Investing Glossary: Standard Deviation*, MORNINGSTAR, http://www.morningstar.com/InvGlossary/standard_deviation.aspx (last visited Jan. 17, 2014) (“Investors use the standard deviation of historical performance to try to predict the range of returns that are most likely for a given fund. When a fund has a high standard deviation, the predicted range of performance is wide, implying greater volatility.”).

²³ Standard deviation measures both “good” and “bad” outcomes, i.e., the variability of returns both above and below the average return. Semi-variance, which can be used to measure the variability of returns *below* the average return, reflects a view of risk as synonymous with “bad” outcomes.

of the measure at multiple points over the life of the fund? If the latter, which specific points over the life of the fund?

- Should a target date fund be required to disclose the same measure or measures that the fund's manager uses to guide its management of the fund, or would other measures be more appropriate?
- Should the risk measure reflect the variance, or volatility, in returns around the fund's average return? Should the measure, instead, reflect the sensitivity of the portfolio's return to the market's return? Or should some other type of risk measure be used? Should these risk measures reflect the characteristics of nominal returns or real returns, which account for the effect of inflation?

Illustration of Risk Measures. We request comment on whether the Commission should develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, its proposed asset allocation glide path illustration and adopt a standard methodology or methodologies to be used in the risk-based glide path illustration.

- Should the rules require a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, the proposed asset allocation glide path illustration? Would the inclusion of two glide path illustrations in the same document tend to confuse investors, and, if so, how could the information be presented in a way that would minimize any confusion?
- Would the proposed asset allocation glide path illustration, without a risk-based glide path illustration, adequately convey risk information to investors? If not,

investors? For example, would one form (*e.g.*, graph) be more easily understandable by investors than another (*e.g.*, table)?

- If we require a risk-based glide path illustration, should we require it to be prominent within the materials where it is included? Are there other presentation requirements that would be more appropriate?
- Should there be differences in requirements for marketing materials that relate to a single target date fund, as compared with those that relate to multiple target date funds? Should a risk-based glide path illustration for a single target date fund be required to show the fund's actual historical risk levels? Would the use of actual historical risk levels be helpful or confusing to investors in cases where a fund has changed its previous glide path? Should the risk-based glide path illustration for a single target date fund instead be permitted to show the current glide path that is common to all target date funds in a fund family? Would it be misleading for marketing materials for a single target date fund to omit the fund's historical risk levels?
- Should the risk-based glide path illustration for a single target date fund be required to clearly depict the current risk level? Should we require the risk level as of the most recent calendar quarter ended prior to the submission of the marketing materials for publication? Are there any circumstances where we should permit the risk-based glide path illustration for a single target date fund to exclude risk levels for past periods? If we permit a single target date fund to exclude past risk levels in any circumstances, should we nonetheless prohibit a fund from excluding past risk levels if the marketing materials contain past

font size or style, apply to the statement that is required to accompany the risk-based glide path illustration?

- Should radio and television advertisements be required to include information about a target date fund's risk-based glide path? What information should be required to be included in radio and television advertisements? For example, is there a means of effectively communicating information comparable to that contained in a risk-based glide path illustration in radio or television advertisements?
- Should information about a target date fund's risk-based glide path be required in marketing materials that are submitted for use on or after the landing point?
- Are there alternative presentations of risk-based measures that would be more helpful to target date fund investors than a risk-based glide path? For example, would it be more helpful to require disclosure of risk measure targets at particular points in time (*e.g.*, target date, landing point) rather than requiring an illustration over the whole life of a target date fund? If so, which points in time would be most important to investors? Should the measures, for example, focus on the target date, landing point, and/or the time period within 5 to 10 years before and after the target date?

Placement of Risk-Based Glide Path Illustration. We request comment on the materials, if any, in which a risk-based glide path illustration for target date funds should be included.

- Are marketing materials for target date funds an appropriate location for inclusion of a risk-based glide path illustration or other information about risk measures? Should illustrations instead be part of the mandated disclosures in a fund's

- If a forward-looking risk measure is used, should the risk measure be calculated using portfolio-based computation, which calculates a portfolio risk measure at each point in time based on the historical behavior of the securities or asset classes that the portfolio is expected to include at that point in time? Should the risk measure instead be a risk objective or target? Do the merits of each approach differ among funds or groups of funds with significant operating histories, new funds, and/or funds that have flexibility to change their risk-based glide paths?
- If a standard based on historical risk characteristics were adopted, what requirements should be imposed on funds with a short operating history?
- Persons submitting comments are also asked to describe as specifically as possible the computation method they would recommend for any quantitative risk measure they favor. For example, persons favoring standard deviation should specify whether monthly returns, quarterly returns, or returns over some other period should be used. As another example, persons favoring beta should describe the benchmark or benchmarks that should be used. Persons submitting comments are also asked to discuss the benefits and limitations associated with their recommended method of computation.

Impact on Investors. We request comment on the impact that disclosure of risk measures and risk-based glide paths would have on investors.

- Would investors in target date funds be likely to understand risk measures, or any related illustrations based on those measures? What means could be used to present risk measures for target date funds in a way that would be understandable to investors? Could investors interpret risk-based illustrations as predicting the

return be computed if it is required? If investors are to receive this information, how best should it be disclosed or presented? Should expected return information be provided as a statistic separate from risk measures or integrated with risk measures as with a confidence interval for returns?

- Would forward-looking disclosures such as projected future volatility (or other risk measures) or expected returns give rise to potential liability concerns? If so, what relief would be necessary to allow funds to provide such disclosures?
- To what extent might special emphasis on investment risk level or asset allocation cause investors to prioritize investment risk at a particular moment in time over longevity risk, inflation risk, or other risks? Should we require additional disclosure to focus investor attention on inflation risks and longevity risks? Are there useful measures of risk that reflect longevity and inflation risk as well as investment risk?

Effects on Portfolio Management. We recognize that required disclosures may affect the management of a fund, such as by causing a fund to adopt investment strategies that result in disclosure that could be perceived more favorably by investors.

- Comments are requested regarding whether, and how, disclosure of a quantitative risk measure or risk-based glide path for target date funds might influence portfolio management. What would be the associated benefits and detriments? For example, might disclosure of a risk measure by target date funds cause those funds to become more conservative either throughout their glide paths or at certain points on the glide path? If so, how would this affect investors, including investors

- If a target date fund does not already calculate the risk measures discussed above, what would the costs—such as programming costs—of calculating such measures be?
- How would the costs and the effects on efficiency, competition, and capital formation of requiring disclosure of a risk-based glide path compare with the costs and effects of the proposed requirements? For example, would a risk-based glide path enhance comparability across different target date funds?

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: April 3, 2014

*Commissioner Aguilar
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71871 / April 4, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31007 / April 4, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15823

In the Matter of

Visionary Trading LLC,
Lightspeed Trading LLC,
Andrew Actman,
Joseph Dondero,
Eugene Giaquinto,
Lee Heiss, and
Jason Medvin,

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934 AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND
CEASE-AND-DESIST ORDERS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Visionary Trading LLC ("Visionary"), Lightspeed Trading LLC ("Lightspeed"), Andrew Actman ("Actman"), Joseph Dondero ("Dondero"), Eugene Giaquinto ("Giaquinto"), Lee Heiss ("Heiss"), and Jason Medvin ("Medvin," and together with Visionary, Lightspeed, Actman, Dondero, Giaquinto, and Heiss, the "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of

these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

A. SUMMARY

1. From May 2008 through November 2011 (the "Relevant Period"), Visionary operated an office in New Jersey where the firm's owners, Dondero, Giaquinto, Heiss, and Medvin (collectively, the "Visionary Owners") and as many as sixteen other individuals engaged in day-trading through various accounts held at Lightspeed, a registered broker-dealer. The sixteen other individuals included two groups: (a) individuals who traded securities using funds provided by the Visionary Owners (the "Visionary Proprietary Traders"); and (b) customers who traded securities using their own funds (the "Visionary Customers"). In connection with their trading, the Visionary Customers paid commissions to Lightspeed, and two Lightspeed registered representatives improperly shared a portion of this transaction-based compensation with Visionary, an unregistered entity. During the Relevant Period, Visionary and the Visionary Owners received \$474,407 of the commissions that were generated by the Visionary Customers' trading, and Lightspeed retained approximately \$330,000 in commissions.

2. By virtue of this conduct, (a) Visionary and the Visionary Owners willfully violated Section 15(a)(1) of the Exchange Act by operating an unregistered broker-dealer; (b) Giaquinto willfully aided and abetted and caused Visionary's, Dondero's, Heiss's, and Medvin's violations of Section 15(a)(1) of the Exchange Act; (c) Lightspeed willfully aided and abetted and caused Visionary's and the Visionary Owners' violations of Section 15(a)(1) of the Exchange Act; (d) Lightspeed failed reasonably to supervise Giaquinto, one of the Visionary Owners, who was also a registered representative of Lightspeed from January 2010 through November 2011, by failing to have reasonable policies and procedures in place designed to prevent and detect commission payments from its registered representatives to persons not registered with the Commission; and (e) Actman failed reasonably to supervise Giaquinto from January 2010 through November 2011 in connection with Giaquinto's aiding and abetting and causing Visionary's, Dondero's, Heiss's, and Medvin's violations of Section 15(a)(1) of the Exchange Act.

3. In addition, one of the Visionary Owners, Dondero, engaged in a sophisticated, manipulative trading strategy, typically referred to as "layering" or "spoofing" (hereinafter, collectively, "layering"). This strategy concerns the use of non-bona fide orders, or orders that

¹ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

a trader does not intend to have executed, to induce others to buy or sell the security at a price not representative of actual supply and demand. As a result of this manipulative trading, Dondero reaped approximately \$984,398 in ill-gotten profits. By virtue of this conduct, Dondero violated Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. RESPONDENTS

4. **Visionary** is a New Jersey limited liability company formed in 2003 by Dondero, Giaquinto, Heiss, and Medvin, which, during the Relevant Period, had its principal place of business in Holmdel, New Jersey. Visionary is not, and has never been, registered with the Commission in any capacity.

5. **Lightspeed** is a New York limited liability company that was formed in 1998. Lightspeed is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act. Lightspeed's principal place of business is in New York, New York.

6. **Actman**, age 41, resides in Demarest, New Jersey. From mid-2007 to late 2010 or early 2011, Actman served as the Chief Executive Officer of Lightspeed. Subsequently, Actman served as Lightspeed's Chief Operating Officer until he left the firm in January 2012. Actman holds Series 7, 24, 27, and 63 licenses. Actman is not currently associated with a registered broker-dealer.

7. **Dondero**, age 37, resides in Lincroft, New Jersey. Dondero is an owner of Visionary. During part of the Relevant Period, Dondero held Series 7, 55, 56, and 63 licenses and was associated with two registered broker-dealers, T3 Trading Group LLC and Chimera Securities LLC.

8. **Giaquinto**, age 40, resides in Monroe, New Jersey. Giaquinto is an owner of Visionary. During part of the Relevant Period, January 2010 through December 2011, Giaquinto held a Series 7 license and was a registered representative associated with Lightspeed.

9. **Heiss**, age 41, resides in Marlboro, New Jersey. Heiss is an owner of Visionary. During part of the Relevant Period, Heiss was associated with a registered broker-dealer, Chimera Securities, LLC. In October 2011, Heiss obtained his Series 56 license.

10. **Medvin**, age 39, resides in Marlboro, New Jersey. Medvin is an owner of Visionary. Medvin does not currently hold any securities licenses, but prior to his involvement with Visionary, he held Series 7, 55, and 63 licenses. During the Relevant Period, Medvin was not associated with a registered broker-dealer.

C. VISIONARY'S RECEIPT OF TRANSACTION-BASED COMPENSATION

11. The Visionary Owners formed Visionary in 2003. They rented an office and outfitted it with computer equipment necessary to permit on-site trading. They then encouraged other traders, including family members, friends, and other associates to trade at their office. The traders included two groups: (a) the Visionary Proprietary Traders; and (b) the Visionary

Customers. By combining their own trading activity with the trading activity of the Visionary Proprietary Traders and the Visionary Customers, the Visionary Owners were able to obtain lower commission rates from the broker-dealers through which they traded. In 2008, the Visionary Owners, the Visionary Proprietary Traders, and the Visionary Customers began trading through accounts maintained at the broker-dealer Lightspeed.

12. From May 2008 through November 2011, Lightspeed charged the Visionary Customers' accounts commissions based on the number of shares traded. Specifically, at the end of each month, Lightspeed calculated the total commissions that the Visionary Customers' accounts paid to Lightspeed. Lightspeed then deducted from this amount: (1) its own previously negotiated share of the commissions, and (2) the Electronic Communication Network ("ECN") fee and other fees that Lightspeed incurred in connection with the trading activity of the Visionary Customers' accounts. Lightspeed then paid the remainder of these commissions to the Lightspeed registered representative affiliated with Visionary. From May 2008 through December 2009, the Lightspeed registered representative was a Visionary proprietary trader (the "Initial Lightspeed Registered Representative") and from January 2010 through November 2011 the Lightspeed registered representative was Giaquinto. The Lightspeed registered representative then gave these commission payments to, or, in the case of Giaquinto, shared these commission payments with, the Visionary Owners.

13. Lightspeed made these payments in the form of checks made out initially to the Initial Lightspeed Registered Representative and later to Giaquinto. The payments were then deposited into a Visionary bank account and disbursements were made to pay office expenses and to make distributions to the Visionary Owners. In total, the Visionary Owners received \$474,407 in connection with the Visionary Customers' trading during the Relevant Period, and Lightspeed retained approximately \$330,000 in commissions.

D. GIAQUINTO KNEW OR WAS RECKLESS IN NOT KNOWING THAT VISIONARY AND THE OTHER VISIONARY OWNERS WERE OPERATING AN UNREGISTERED BROKER-DEALER

14. Giaquinto was both a registered representative associated with Lightspeed and an owner of Visionary from January 2010 through November 2011. During this time, Giaquinto received commission payments from Lightspeed for the Visionary Customers' trading and deposited this money into a Visionary bank account to pay office expenses and to make payments to the other Visionary Owners. Giaquinto knew that the other Visionary Owners were receiving a portion of the Lightspeed commission payments. He and the other Visionary Owners communicated frequently about how they should divide the commission payments amongst themselves.

E. LIGHTSPEED KNEW OR WAS RECKLESS IN NOT KNOWING THAT ITS REGISTERED REPRESENTATIVES WERE IMPROPERLY SHARING TRANSACTION-BASED COMPENSATION

15. Beginning in at least June 2008, Lightspeed encountered red flags indicating that the Initial Lightspeed Registered Representative and later Giaquinto were transferring to

Visionary the transaction-based compensation that Lightspeed paid them in connection with the trading activity of the Visionary Customers. Lightspeed further encountered red flags indicating that Visionary, which was not a registered broker-dealer, was distributing these payments to the Visionary Owners, who during portions of the Relevant Period were not registered as brokers or dealers or associated with a registered broker-dealer.²

16. For example, the Visionary Owners, including Medvin who was not associated with any registered broker-dealer, arranged on a regular basis the gross commission that Lightspeed would charge each of the Visionary Customers. Medvin, as opposed to the Initial Lightspeed Registered Representative or Giaquinto, contacted Actman and other Lightspeed employees concerning the payment of the transaction-based compensation to Visionary. Lightspeed would then deduct from this gross commission amount its own commission and ECN and related fees, and pay the remainder of the transaction-based compensation to the Lightspeed registered representative associated with Visionary at the time. Actman sent, or was copied on, monthly spreadsheets that Lightspeed provided to Medvin identifying the total commissions that Lightspeed charged the Visionary Customer accounts and how much of those commissions Lightspeed would pay to the Initial Lightspeed Registered Representative and later Giaquinto. Throughout the Relevant Period, Actman and others at Lightspeed knew that Giaquinto was affiliated with Visionary. Lightspeed's knowledge of this affiliation, Giaquinto's status as a Lightspeed registered representative, and Lightspeed's regular communication with Medvin about Lightspeed's payment of transaction-based compensation placed Lightspeed on notice that the commission payments related to the Visionary Customers' trading were being transferred to the Visionary Owners.

17. These red flags indicated that the Visionary Owners arranged the Visionary Customer commission rates and received the transaction-based compensation that Lightspeed was paying to its registered representatives. Despite these red flags, no one at Lightspeed responded reasonably to prevent these payments from occurring; instead, Lightspeed continued to make the monthly payments.

F. LIGHTSPEED AND ACTMAN FAILED REASONABLY TO SUPERVISE GIAQUINTO WITH RESPECT TO HIS AIDING AND ABETTING VIOLATIONS OF SECTION 15(a)(1)

18. Lightspeed failed to establish reasonable policies and procedures designed to prevent and detect the improper sharing of commissions between its registered representatives, such as Giaquinto, and persons who were not registered with the Commission in any capacity. In addition, Lightspeed failed to establish reasonable policies and procedures to guide its employees' responses to red flags suggesting that a registered representative, such as Giaquinto,

² From May 2008 through December 2009, the Initial Lightspeed Registered Representative received commission payment checks from Lightspeed and endorsed these checks over to the Visionary Owners. Then from January 2010 through November 2011, Giaquinto, a Visionary Owner and Lightspeed registered representative, received commission payment checks from Lightspeed and endorsed them over to the other Visionary Owners.

might be sharing commissions with an unregistered entity or person. If Lightspeed had adopted reasonable policies and procedures to monitor for commission-sharing between its registered representatives and others or to guide its employees in identifying and responding to red flags indicating inappropriate commission-sharing, it is likely that Lightspeed would have prevented and detected Giaquinto's aiding and abetting violations of Section 15(a)(1).

19. Actman supervised Giaquinto from January 2010 through November 2011. As described above, Actman was contacted by Medvin, not Giaquinto, to establish commission rates for the Visionary Customers. Further, Actman knew prior to January 2010 and through the remainder of the Relevant Period that Giaquinto was affiliated with Visionary. In May 2010, Actman contacted Medvin and told him that Lightspeed would not continue to pay Giaquinto a share of the commissions related to the trading by the Visionary Proprietary Traders so long as Giaquinto remained an owner of Visionary.

20. Although Lightspeed did stop paying Giaquinto commissions related to certain Visionary Proprietary Traders trading, Lightspeed's payments of commissions related to the Visionary Customers' trading continued through November 2011 with no changes to Giaquinto's ownership interest in Visionary. Giaquinto also continued to share the commission payments with Visionary and the other Visionary Owners. Actman failed to take any other steps to address the red flags that suggested that Giaquinto was sharing commissions with Visionary and the other Visionary Owners. If Actman had followed up on these red flags, it is likely that he would have prevented and detected Giaquinto's aiding and abetting violations of Section 15(a)(1).

G. DONDERO'S MANIPULATIVE TRADING SCHEME

21. During the Relevant Period, Dondero repeatedly manipulated the markets of U.S. listed and over-the-counter stocks by engaging in the practice of layering. Layering concerns the use of non-bona fide orders, or orders that the trader does not intend to have executed, to induce others to buy or sell the security at a price not representative of actual supply and demand. More specifically, Dondero placed buy (or sell) orders that he intended to have executed, and then immediately entered numerous non-bona fide sell (or buy) orders for the purpose of attracting interest to the bona fide order. Dondero placed these non-bona fide orders to induce, or trick, other market participants to execute against the initial, bona fide order. Immediately after the execution against the bona fide order, Dondero cancelled the open, non-bona fide orders. He typically then repeated this strategy on the opposite side of the market to close out the position.

22. Using this strategy, Dondero induced other market participants to trade in a particular security by placing and then cancelling layers of orders in that security, creating fluctuations in the national best bid or offer of that security, increasing order book depth, and using the non-bona fide orders to send false signals regarding the demand for such security, which the other market participants misinterpreted as reflecting true demand. Dondero's orders were intended to deceive and did deceive other market participants into buying (or selling) stocks from (or to) Dondero at prices that had been artificially raised (or lowered) by Dondero.

Example of Layering by Dondero

23. Dondero's trading in the stock of First Capital, Inc. (FCAP) from 9:34:24 to 9:54:09 on May 8, 2009, illustrates his pattern of layering. At 9:34:25, Dondero placed an order to buy 100 shares of FCAP at \$16.20 per share. Prior to Dondero placing his order, the inside bid was \$14.01 and the inside ask was \$17.00. Dondero's buy order raised the National Best Bid ("NBB") from \$14.01 to \$16.20. At 9:34:29, Dondero placed an order to sell 2,000 shares of FCAP at \$16.21 per share. This order did not change the National Best Offer ("NBO") because Dondero used an order type that allowed him to not display his order to other market participants; thus, the NBO remained at \$17.00.

24. At 9:34:31, Dondero placed two orders to buy a total of 1,000 shares of FCAP at \$16.20. He immediately cancelled these orders and placed another order at 9:34:35 to buy 100 shares of FCAP for \$15.10. The NBB at this point was still \$16.20, established by Dondero's open orders. At 9:36:49, Dondero again placed two orders to buy a total of 1,000 shares of FCAP at \$16.20 and then immediately cancelled those orders. At 9:36:51, Dondero placed an order to buy 100 shares of FCAP at \$16.10 and then cancelled his only other outstanding buy order at \$16.20. At this point, the NBB was \$16.10, representing Dondero's open orders. Apparently realizing that his bona-fide sell order was not getting executed, he then cancelled his outstanding sell order of 2,000 shares at \$16.21. At 9:36:56, he placed a new non-displayed order to sell 2,000 shares of FCAP for \$16.11 per share, one cent higher than his current order to buy. At 9:36:57, he placed four orders to buy a total of 2,000 shares of FCAP at \$16.10, cancelling one of those 500 share orders. At 9:36:59, 500 shares of Dondero's outstanding sell order were sold at \$16.11 per share. At 9:37:00, he then placed three additional 500 share buy orders at \$16.10. At 9:37:01, 300 shares of his 2,000 share sell order were sold at \$16.11. He then proceeded to cancel most of his outstanding buy orders.

25. For twenty minutes, Dondero's orders constituted the best bid, dropping it over time to \$16.00. He cancelled buy orders during this time, but always had at least one buy order open. The purpose of maintaining an open bid appears to be that it prevents the best bid from falling substantially. During this time, he placed non-displayed sell orders near the best bid in the range of \$16.01 to \$16.21. He managed to sell 1,700 shares for an average price of \$16.06. He purchased no shares during this time. When Dondero cancelled all of his remaining buy orders at 9:54:07, the NBB returned to \$14.01. The best offer was \$16.50 at this time. During this time, Dondero placed 36 buy orders while only placing 9 sell orders. Dondero covered his short position the next day yielding him approximately \$2,919 in profits.

26. Dondero engaged in this manipulative strategy repeatedly, placing hundreds of thousands of orders during the Relevant Period with the intent to change the NBB or NBO while at times cancelling greater than 90 percent of his orders.

27. The manipulative trading comprised almost 100 percent of Dondero's profitable trading and resulted in profits of \$984,398.

H. VIOLATIONS

Visionary and the Visionary Owners Willfully Violated Exchange Act Section 15(a)(1)

28. As a result of the conduct described above, Visionary and the Visionary Owners willfully³ violated Section 15(a)(1) of the Exchange Act by operating as an unregistered broker-dealer.⁴ In particular, while not registered in any capacity with the Commission, Visionary and the Visionary Owners solicited the Visionary Customers to engage in securities trading through accounts at Lightspeed, and received transaction-based compensation related thereto.

Giaquinto Willfully Aided and Abetted and Caused Visionary's and Visionary Owners' Violations of Exchange Act 15(a)(1)

29. As a result of the conduct described above, from January 2010 through November 2011, Giaquinto willfully aided and abetted and caused Visionary's and the Visionary Owners' violations of Section 15(a)(1) of the Exchange Act by knowingly or recklessly facilitating Visionary's and Dondero's, Heiss's, and Medvin's operation of an unregistered broker-dealer.

Lightspeed Willfully Aided and Abetted and Caused Visionary's and the Visionary Owners' Violations of Exchange Act 15(a)(1)

30. As a result of the conduct described above, Lightspeed willfully aided and abetted and caused Visionary and the Visionary Owners' violations of Section 15(a)(1) of the Exchange Act by knowingly or recklessly facilitating Visionary and the Visionary Owners' operation of an unregistered broker-dealer.

Lightspeed Failed Reasonably to Supervise Giaquinto

31. As a result of the conduct described above, Lightspeed failed reasonably to supervise Giaquinto while he was a registered representative associated with Lightspeed within the meaning of Section 15(b)(4)(E) of the Exchange Act with a view to preventing and detecting his violation of the federal securities laws.

³ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

⁴ Prior to becoming associated with Lightspeed in January 2010, Giaquinto, as a Visionary Owner, violated Section 15(a)(1) of the Exchange Act by receiving a portion of Lightspeed payments that were based on the trading of the Visionary Customers.

Actman Failed Reasonably to Supervise Giaquinto

32. Supervisors have a heightened duty to supervise and act decisively in investigating and taking appropriate action in response to red flags indicating possible fraud or other irregularity. From January 2010 through November 2011, Actman supervised Giaquinto while he was a registered representative associated with Lightspeed.

33. As a result of the conduct described above, Actman failed reasonably to supervise Giaquinto within the meaning of Section 15(b)(4)(E) of the Exchange Act, as incorporated by reference in Section 15(b)(6) of the Exchange Act, with a view to preventing and detecting his violation of the federal securities laws.

Dondero Violated Exchange Act Sections 9(a)(2) and 10(b) and Rule 10b-5 Thereunder⁵

34. As a result of the conduct described above, Dondero willfully violated Section 9(a)(2) of the Exchange Act, which makes it unlawful "to effect, alone or with one or more other persons, a series of transactions in any security . . . creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

35. As a result of the conduct described above, Dondero willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful, in connection with a purchase or sale of securities, to: (1) employ any device, scheme or artifice to defraud; (2) make material misstatements of fact or omit to state material facts; or (3) engage in any act or practice that operates as a fraud or deceit.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents Visionary and Lightspeed shall cease and desist from committing or causing any violations and any future violations of Section 15(a)(1) of the Exchange Act.

B. Respondents Dondero, Giaquinto, Heiss, and Medvin shall cease and desist from committing or causing any violations and any future violations of Section 15(a)(1) of the Exchange Act.

⁵ Unlike Section 15(a)(1) of the Exchange Act, which does not require scienter (*see SEC v. Nat'l Executive Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980)), Sections 9(a)(2) and 10(b) of the Exchange Act require proof of scienter.

C. Respondent Dondero shall cease and desist from committing or causing any violations and any future violations of Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

D. Respondents Giaquinto, Heiss, and Medvin be, and hereby are:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

E. Respondent Dondero be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

F. Respondent Actman be, and hereby is, barred from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with the right to apply for reentry after one year to the appropriate self-regulatory organization, or if there is none, to the Commission.

G. Respondent Lightspeed is censured.

H. Any reapplication for association by Respondents Actman, Dondero, Giaquinto, Heiss, and Medvin will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondents Actman, Dondero, Giaquinto, Heiss, and Medvin, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

I. Respondent Lightspeed shall pay disgorgement of \$330,000 and prejudgment interest of \$43,316.54 for a total of \$373,316.54, plus agreed upon post-Order interest of \$4,592.16, for a total of \$377,908.70, to the United States Treasury. Payment of disgorgement and interest shall be made in five (5) installments according to the following schedule:

- Payment 1, in the amount of \$125,000, due within ten (10) days of the entry of this Order.
- Payment 2, in the amount of \$63,916.00, due within ninety (90) days of the entry of this Order.
- Payment 3, in the amount of \$63,456.78, due within one hundred eighty (180) days of the entry of this Order.
- Payment 4, in the amount of \$62,997.57, due within two hundred seventy (270) days of the entry of this Order.
- Payment 5, in the amount of \$62,538.35, due within three hundred sixty (360) days of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, plus any additional interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;⁶
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal

⁶ The minimum threshold for transmission of payment electronically is \$1,000,000. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lightspeed as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

J. Respondent Lightspeed shall pay a civil money penalty in the amount of \$100,000 plus agreed upon post-Order interest of \$308.22, for a total of \$100,308.22, to the United States Treasury. Payment of penalty and interest shall be made in five (5) installments according to the following schedule:

- Payment 1, in the amount of \$50,000, due within ten (10) days of the entry of this Order.
- Payment 2, in the amount of \$12,623.29, due within ninety (90) days of the entry of this Order.
- Payment 3, in the amount of \$12,592.47, due within one hundred eighty (180) days of the entry of this Order.
- Payment 4, in the amount of \$12,561.64, due within two hundred seventy (270) days of the entry of this Order.
- Payment 5, in the amount of \$12,530.82, due within three hundred sixty (360) days of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;⁷
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

⁷ See *supra* note 5.

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lightspeed as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

K. Respondents Giaquinto, Heiss, and Medvin each shall, within ten (10) days of the entry of this Order, pay disgorgement of \$118,601.96 plus prejudgment interest of \$14,391.32 for a total of \$132,993.28 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;⁸
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Giaquinto, Heiss, or Medvin as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

L. Respondents Giaquinto, Heiss, and Medvin each shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$35,000 to the United States

⁸ See *supra* note 5.

Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;⁹
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Giaquinto, Heiss, or Medvin as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

M. Respondent Dondero shall, within (10) days of the entry of this Order, pay disgorgement of \$1,102,999.96 plus prejudgment interest of \$46,792 for a total of \$1,149,791.96 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;¹⁰
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center

⁹ See *supra* note 5.

¹⁰ See *supra* note 5.

Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Dondero as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

N. Respondent Dondero shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$785,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;¹¹
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Dondero as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

O. Respondent Actman shall pay a civil money penalty in the amount of \$10,000 plus agreed upon post-Order interest of \$46.23, for a total of \$10,046.23, to the United States Treasury. Payment of penalty and interest shall be made in five (5) installments according to the following schedule:

¹¹ See *supra* note 5.

- Payment 1, in the amount of \$2,500, due within ten (10) days of the entry of this Order.
- Payment 2, in the amount of \$1,893.49, due within ninety (90) days of the entry of this Order.
- Payment 3, in the amount of \$1,888.87, due within one hundred eighty (180) days of the entry of this Order.
- Payment 4, in the amount of \$1,884.25, due within two hundred seventy (270) days of the entry of this Order.
- Payment 5, in the amount of \$1,879.62, due within three hundred sixty (360) days of the entry of this Order.

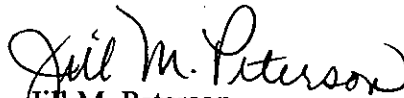
If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;¹²
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Actman as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

By the Commission.


Jill M. Peterson
Assistant Secretary

¹² See *supra* note 5.

*Commissioner Aguilar
not participating*

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 71866 / April 4, 2014

Admin. Proc. File No. 3-14587

In the Matter of

ABSOLUTE POTENTIAL, INC.
(f/k/a Absolute Waste Services, Inc.)
c/o Randall D. Lehner, Esq.
Ulmer Berne LLP
500 West Madison Street, Ste. 3600
Chicago, IL 60661-4587

OPINION OF THE COMMISSION

SECTION 12(j) PROCEEDING

Grounds for Remedial Action

Failure to Comply with Periodic Filing Requirements

Company failed to timely file periodic reports in violation of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13. *Held*, it is necessary and appropriate for the protection of investors to revoke the registration of the company's securities.

APPEARANCES:

Randall D. Lehner and *Kasey M. Folk*, of Ulmer & Berne LLP, for Absolute Potential, Inc. (f/k/a Absolute Waste Services, Inc.).

Alfred A. Day and *Neil J. Welch, Jr.*, for the Division of Enforcement.

Appeal filed: March 22, 2012
Last brief received: December 11, 2013
Oral argument: December 16, 2013

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Absolute Potential, Inc. appeals an administrative law judge's decision to revoke the registration of its common stock pursuant to Securities Exchange Act Section 12(j).¹ The law judge revoked the registration after finding that Absolute violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13² when it failed to file twenty annual and quarterly reports due from 2006 through 2011.³ Absolute concedes the violations but challenges the revocation of its stock, arguing that revocation is contrary to Commission precedent and the public interest since it filed all delinquent reports during the course of these administrative proceedings. Based on an independent review of the record, we determine that revocation of Absolute's securities registration is not inconsistent with relevant precedent and serves the public interest because revocation is necessary for the protection of investors.

I. Background

A. Absolute is a shell company with few assets and ineffective internal controls over financial reporting.

Absolute is a shell company⁴ incorporated in Florida and based in Chicago, Illinois.⁵ As of September 30, 2013, Absolute reported total assets of \$27, an accumulated deficit of \$1,972,404, and negative shareholder equity. Absolute had approximately 275 record holders of common stock and 646,176 shares outstanding as of September 30, 2013.⁶ In its 2013 annual

¹ 15 U.S.C. § 78l(j).

² 15 U.S.C. § 78m(a); 17 C.F.R. §§ 13a-1 and 13a-13.

³ *Ablest Inc.*, Initial Decision Release No. 453, 2012 WL 681586, at *1 (Feb. 15, 2012).

⁴ "A 'shell' company is an inactive or defunct corporation with little or no assets which carries on no business activity." *United States v. Sneed*, 34 F.3d 1570, 1574 n.2 (10th Cir. 1994). We have observed that shell companies are "attractive vehicles for fraudulent stock manipulation schemes," and thus "[r]evocation under § 12(j) can make such issuers less appealing to persons who would put them to fraudulent use." *e-Smart Techs., Inc.*, Exchange Act Release No. 50514, 2004 WL 2309336, at *2 n.14 (Oct. 12, 2004).

⁵ The company has had no material operations since 2004 and is "not presently engaged in, and do[es] not plan to engage in, any substantive commercial business for an indefinite period of time." Absolute Potential, Inc., Form 10-K for the year ended Sept. 30, 2013, at 5. We take official notice of the EDGAR filings cited in this opinion pursuant to Rule of Practice 323, 17 C.F.R. § 201.323 (permitting the Commission to take official notice of, for example, "any matter in the public official records of the Commission," such as periodic reports filed in the EDGAR database).

⁶ Form 10-K for the year ended Sept. 30, 2013, at 12. The company's common stock, which was registered pursuant to Exchange Act Section 12(g), 15 U.S.C. § 78l(g), was delisted from the OTC Bulletin Board on August 11, 2003 and, according to Absolute, currently has no public trading market. *Id.*

report, Absolute disclosed that its "internal controls over financial reporting were ineffective as of September 30, 2013," and noted that "there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis."⁷

Thomas F. Duszynski is Absolute's sole employee, director, and officer. As of December 24, 2013, he beneficially owned 97% of the company's outstanding voting securities. Duszynski holds the shares indirectly through Augustine Fund, L.P., a private equity investment firm for which he is a principal, and PAC Funding, LLC, which is managed by Augustine Fund. Augustine Fund provides Absolute with rent-free office space and equipment and has advanced cash to the company since 2005. In its 2013 annual report, Absolute acknowledged that the outstanding balance of Augustine Fund's advances was \$998,988.⁸ Absolute further stated: "We do not have sufficient funds to engage in significant operating activities. Our future operating activities are expected to be funded by loans from a major shareholder. However, none of our shareholders has any obligation to provide such loans to us."

B. Absolute failed to file twenty annual and quarterly periodic reports due from 2006 through 2011.

In 2006, Absolute had not filed its Form 10-KSB for the year ended September 30, 2005, and its Forms 10-QSB for the quarters ended December 31, 2005, March 31, 2006, and June 30, 2006.⁹ On September 14, 2006, Commission staff from the Division of Corporation Finance sent a letter (the "Delinquency Letter") to Absolute, noting that the company was not in compliance with its reporting requirements and warning that, without further notice, the Commission could institute an administrative proceeding to determine whether to revoke the company's registration if it did not file the required reports within fifteen days of the date of the letter.¹⁰ Notwithstanding the warning, Absolute neither responded nor filed the reports within fifteen days, eventually filing the Form 10-KSB on May 29, 2007 and the three Forms 10-QSB on September 19, 2008. Absolute did not file any other reports for subsequent periods through

⁷ *Id.* at 19.

⁸ Those advances are unsecured and have no repayment terms, but they are convertible into shares of common stock. At oral argument, counsel for Absolute stated that the advances were used "to fund various operations for Absolute, including the filings that it has made now, the filings it had made in the past [including those related to the unwinding of a merger], various operational administrative expenses that are associated," and "legal expenses."

⁹ The Commission eventually stopped permitting small business issuers to use these forms in lieu of Forms 10-K and 10-Q. See *Smaller Reporting Company Regulatory Relief and Simplification*, 73 Fed. Reg. 934 (Jan. 4, 2008) (eliminating Regulation S-B and phasing out the forms associated with it).

¹⁰ The staff sent the letter by certified mail with a return receipt requested, and the record contains a signed receipt dated September 20, 2006. At oral argument, Absolute's counsel claimed that Absolute did not receive the Delinquency Letter.

2011.¹¹ Commission records also show that, in addition to failing to file any additional Forms 10-K or 10-Q during this period, Absolute failed to file (as required) any Forms 12b-25 notifying the Commission that it would not make those filings.¹² Absolute has never offered any explanation for its delinquencies but, when asked at oral argument in this proceeding, its counsel explained that "there were individuals at Absolute who may have been aware of that [reporting] obligation but who, because of the problems that they were having, . . . and the disarray of the unwinding of the merger and the lack of reliable accounting and auditing relationships, it did not get done."¹³

C. Proceedings were instituted pursuant to Exchange Act Section 12(j), and Absolute's securities registration was revoked.

On October 14, 2011, we issued an Order Instituting Proceedings ("OIP") alleging that Absolute failed to file quarterly and annual reports as required under Exchange Act Section 13(a)

¹¹ A table summarizing Absolute's delinquent filings is attached as Exhibit 1.

¹² See Exchange Act Rule 12b-25, 17 C.F.R. § 201.12b-25(a) (requiring issuers to give the Commission notice of their inability to file a periodic report, together with an explanation, by filing a Form 12b-25 "no later than one business day after the due date" for such report); Form 12b-25, 17 C.F.R. § 249.322.

Although not alleged in the OIP, it appears that the company also failed to file proxy statements as required under Exchange Act Section 14. See *Robert Bruce Lohmann*, Exchange Act Release No. 48092, 56 SEC 573, 2003 WL 21468604, at *5 & n.20 (June 26, 2003) (finding that matters "not charged in the OIP" may nevertheless be considered "in assessing sanctions"). Under Florida law, Absolute is required to elect at least one-third of its directors annually. FLA. STAT. ANN. §§ 607.0803 & 607.0806 (West 2011). Assuming that the company adhered to this provision, it would have been required either to: (1) solicit proxies for a director election and to file a proxy statement with the Commission pursuant to Exchange Act Section 14(a), 15 U.S.C. § 78l(a), and Rule 14a-3 thereunder, 17 C.F.R. § 240.14a-3; or (2) file an information statement with the Commission, inclusive of "information substantially equivalent to the information which would be required to be transmitted if a [proxy] solicitation were made," pursuant to Exchange Act Section 14(c), 15 U.S.C. § 78l(c), and Rule 14c-2 thereunder, 17 C.F.R. § 240.14c-2. *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *9 n.44 (June 29, 2012). The company has filed neither proxy statements nor information statements regarding director election.

¹³ In response to further questioning, counsel admitted that Absolute was not "on top" of its obligations:

Q: I'm just trying to get clear that people in Absolute knew they had a filing obligation but they ended up not filing even though they had knowledge of it. Can you enlighten me as to why people with knowledge of a filing obligation chose not to meet those obligations or contact the staff about those obligations?

A: I don't believe that they were on top of what their obligations were at the time.

and Rules 13a-1 and 13a-13 and instituting proceedings to determine whether revocation or suspension of the registration of the company's securities was necessary or appropriate to protect investors.¹⁴ In its answer to the OIP, Absolute admitted that it had not filed twenty required annual and quarterly reports due in 2006 through 2011. During a November 18, 2011 prehearing conference, Absolute promised to become current in its filings by the end of 2011. It missed that self-imposed deadline but filed all of its delinquent reports by January 6, 2012.

The parties filed cross-motions for summary disposition on January 9, 2012, and the administrative law judge granted the Division's motion in a February 15, 2012 initial decision.¹⁵ The law judge found, without dispute, that Absolute violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13, and determined that revoking Absolute's securities registration was in the public interest. In making that assessment, she considered, among other things, the decisional factors identified in *Gateway Int'l Holdings, Inc.*, discussed below.¹⁶

Although the law judge found it mitigating that Absolute had filed all past-due reports and "ha[d] a present intention to remain current,"¹⁷ she concluded that Absolute's demonstrated pattern of delinquency and "the fact that the company has no revenue . . . bodes ill for its future compliance," rendering the company's assurances of future compliance not credible.¹⁸ In reaching this conclusion, the law judge found that Absolute had an "utter lack of resources with which to pay for compiling and auditing or reviewing its financial statements" even though the company presented assertedly contrary evidence.¹⁹ Despite such evidence, the law judge held that "there is no genuine issue with regard to any material fact."²⁰

¹⁴ The OIP charges Absolute with "having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2006."

¹⁵ *Ablest Inc.*, 2012 WL 681586, at *5; see also 17 C.F.R. § 201.250(a) (providing that, after a respondent's answer has been filed and documents have been made available to it for inspection and copying, a party may move for summary disposition of any of the allegations in the order instituting proceedings). As a result, there was no hearing, and the record on appeal is limited to the parties' filings, supplemented by attachments, and those matters of which we may take official notice.

¹⁶ *Ablest Inc.*, 2012 WL 681586, at *4 (citing *Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 53907, 2006 WL 1506286, at *4 (May 31, 2006)).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ In support of its opposition to the Division's motion for summary disposition during the proceedings below, Absolute attached the declaration of Duszynski, who controls the company. In the declaration, Duszynski noted that Absolute made twenty-one periodic filings of its Forms 10-K and 10-Q between December 16, 2011 and January 6, 2012. He also stated that Absolute's accountants and auditors expended approximately 285 hours, generating fees of approximately \$62,000. Duszynski promised that Absolute "will take all necessary steps to ensure ongoing compliance," in part, because it had "established regular and reliable relationships with new
(continued...)

D. Absolute's subsequent filings have been timely but have contained inaccuracies.

Since the issuance of the initial decision in this case, Absolute timely filed its Forms 10-K for the years ended September 30, 2012 and 2013, and its Forms 10-Q for the quarters ended March 31, June 30, and December 31, 2012, and March 31, June 30, and December 31, 2013.

On November 20, 2013, the Division sought leave to adduce a declaration from an Assistant Chief Accountant in Corporation Finance that identifies inaccuracies in Absolute's Forms 10-Q for the quarters ended June 30, 2013 and March 31, 2012. We grant the Division's motion pursuant to Rule of Practice 452.²¹

On December 11, 2013, the company filed a cross-motion seeking to adduce additional evidence in the form of a declaration by a manager who works for Absolute's accountant—a firm that appears to be responsible for preparing Absolute's quarterly and annual reports. Absolute asserts that the declaration "establishes that . . . the errors contained in Absolute's March 31, 2012 Form 10-Q and June 30, 2013 Form 10-Q were inadvertent and immaterial."²² According to Absolute, the declaration also demonstrates that the company "acted swiftly in correcting such errors as soon as it became aware of their existence and attaches amended Form 10-Qs for the

(...continued)

accountants and auditors." To that end, Absolute says that it has "instituted processes to make its future periodic filings on a timely basis," although it does not describe those processes. In addition, Absolute asserted in its briefs that Duszynski's private equity fund (Augustine Fund) had advanced the company over \$800,000 from 2005 to 2011 and had provided funding for the company to complete its delinquent and subsequent filings.

²⁰ *Ablest Inc.*, 2012 WL 681586, at *1. The law judge also found that "[a]ny other facts in Absolute Potential's pleading have been taken as true . . . pursuant to 17 C.F.R. § 201.250(a)." Under Rule 250, a law judge may grant a motion for summary disposition "if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law." 17 C.F.R. § 201.250(b).

²¹ Rule of Practice 452 provides that a party may file a motion for leave to adduce additional evidence at any time prior to issuance of a decision by the Commission, and that "[s]uch motion shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." 17 C.F.R. § 201.452. The Division states that the additional evidence is material, particularly with respect to the credibility of Absolute's assurances against future violations. The Division also states that the evidence was not adduced previously because one Form 10-Q at issue was filed after appeal briefing was complete, and the other Form 10-Q at issue was not reviewed sooner due to limited resources and the prioritization of those resources on active, pending investigations.

²² Absolute asserts that "these errors would not 'have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available' or as 'important in deciding how to [act] . . .'" (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

periods ended March 31, 2012 and June 30, 2013." Absolute filed those reports on December 6, 2013. We grant Absolute's motion as to the declaration pursuant to Rule 452.²³ We deny as moot Absolute's motion as to the company's filings because we have taken official notice of such filings.²⁴ As discussed below, we have considered the Company's subsequent filing history in assessing the need for sanctions.

II. Analysis

A. Absolute violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13.

Exchange Act Section 13(a) requires issuers of securities registered under Exchange Act Section 12 to file with the Commission annual and quarterly reports "for the proper protection of investors and to insure fair dealing" in the company's securities.²⁵ Exchange Act Rules 13a-1 and 13a-13 set forth the requirements for those reports.²⁶ Absolute concedes that it did not file twenty annual and quarterly reports due from 2006 through 2011. Accordingly, we find that the company violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13.

B. The *Gateway* factors justify revocation under these circumstances.

Exchange Act Section 12(j) authorizes us, as we deem necessary or appropriate for the protection of investors, to either suspend the registration of a security for a period not exceeding twelve months or to revoke it if an issuer fails to comply with any provision of the Exchange Act or its rules and regulations.²⁷ In determining the appropriate sanctions under Section 12(j), we are guided by the non-exclusive public interest factors first set forth in *Gateway Int'l Holdings, Inc.*²⁸ They include (i) the seriousness of the issuer's violations; (ii) the isolated or recurrent nature of the violations; (iii) the degree of culpability involved; (iv) the extent of the issuer's efforts to remedy its past violations and ensure future compliance; and (v) the credibility of its assurances, if any, against further violations.²⁹ We find that, based on these factors, it is

²³ Absolute asserts that the declaration and filings it seeks to introduce "is unquestionably material in light of Enforcement's motion, and [that] there are reasonable grounds for the failure to adduce such evidence previously because Enforcement only informed Absolute of the alleged deficiencies on November 20, 2013 through its motion."

²⁴ See *supra* note 5. We similarly deny as moot Absolute's request that we admit several documents that Absolute attached to its petition for review because they are either documents that are already part of the record or are filings of which we have taken official notice.

²⁵ 15 U.S.C. § 78m(a).

²⁶ 17 C.F.R. §§ 240.13a-1, 13a-13.

²⁷ 15 U.S.C. § 78l(j).

²⁸ 2006 WL 1506286, at *4.

²⁹ *Id.*

necessary and appropriate for the protection of investors to revoke Absolute's securities registration.

Absolute's violations were serious and recurrent. The company failed to timely file four periodic reports due in 2005 and 2006 and then ignored the warning in Corporation Finance's Delinquency Letter to remedy those delinquencies within fifteen days, instead completing the filings approximately two years later.³⁰ Absolute then failed to file any reports due for periods ending after June 30, 2006—a span of five years at the time the OIP issued—and did not file a Form 12b-25 to notify the Commission of its delinquencies.³¹ Absolute's violations involved a high degree of culpability. The company knew of, yet repeatedly disregarded, its reporting obligations. For the first time since these proceedings were instituted, Absolute's counsel, at oral argument, claimed vaguely that the company's lengthy delinquencies resulted from "disarray" associated with a merger and a "lack of reliable accounting and auditing relationships."³² Absolute's tardy and unilluminating explanation for its years of noncompliance supports our finding that the company essentially ignored its reporting obligations until it was ultimately confronted with revocation through the institution of these proceedings.³³

We acknowledge Absolute's remedial efforts but conclude, based on the undisputed material facts of this case, that those efforts are insufficient to overcome the need for revocation. As noted, Absolute spent time and money to file all outstanding reports and, through Duszynski's declaration, represented that it will take "all necessary steps to ensure ongoing compliance," in part, because it had "established regular and reliable relationships with new accountants and auditors." Absolute reasons that its remedial efforts, including the ability to fund the filing of its reports, demonstrate that it will not engage in future violations. To that end, Absolute argues that the law judge erred in deciding to revoke the company's securities registration on summary disposition because the law judge "failed to recognize, at a minimum, a genuine issue of material

³⁰ As noted, it appears that the Company failed to file proxy statements as required under Exchange Act Section 14. *See supra* note 12.

³¹ *See Cobalis Corp.*, Exchange Act Release No. 64813, 2011 WL 2644158, at *6 n.31 (July 6, 2011) (considering, in assessing the sanction, the issuer's failure to file Forms 12b-25 in connection with delays in its periodic reports, although such failures were not alleged in the OIP).

³² Record evidence contradicts Absolute's counsel's claim that Absolute did not receive the Delinquency Letter. *See supra* note 10.

³³ We have previously noted that, under certain circumstances, registrants such as Absolute that are unable or unwilling to continue to comply with reporting requirements have the option of deregistering their stock under the Exchange Act, by filing a Form 15. *See Gateway*, 2006 WL 1506286, at *2 n.10 (setting forth the requirements for deregistration of an issuer's securities). Absolute's filings indicate that it had fewer than 300 stockholders of record, and thus was eligible for deregistration. But there is no evidence that Absolute ever sought deregistration as a means of dealing with its filing problems. At oral argument, Absolute's counsel stated that he was not aware of whether Absolute considered filing a Form 15.

fact as to Absolute's ability to pay for the required filings in the future," and thus "impermissibly weighed evidence to determine the truth [*i.e.*, credibility] of Absolute's assurances against future reporting violations."

We disagree. While Rule 250 precludes the granting of summary disposition where there are material factual disputes between the parties, "[n]ot every alleged factual dispute precludes summary disposition. To prevent summary disposition, the opposing party must present facts demonstrating a genuine issue of fact that is material to the charged violation."³⁴ In granting summary disposition, the law judge determined that Absolute had an "utter lack of resources with which to pay for compiling and auditing or reviewing its financial statements." Although Augustine Fund demonstrated a willingness to provide extensive financial support, through loans, it was not legally bound to do so. But even if we were to assume that Augustine Fund's historical funding of Absolute's operations would continue and that Absolute had sufficient funds to meet its periodic filing obligations, we find that Absolute's assurances of future compliance are not credible. The undisputed *material* facts in the record regarding Absolute's protracted delinquencies, unpersuasive explanations for those delinquencies, and the absence of concrete remedial changes³⁵ to ensure compliance demonstrate that Absolute is likely to violate the reporting requirements in the future regardless of the viability of its funding resources.

Moreover, Absolute has continued to struggle with its ability to establish and maintain "internal control over financial reporting."³⁶ Absolute acknowledged that two recently filed quarterly reports contained inaccuracies. It asserted that the errors were inadvertent and immaterial, that it has since filed amended reports, and that its accountant had made the errors. But, even accepting Absolute's assertions, it is ultimately the *company's* responsibility to file accurate reports. Part of that responsibility includes having effective controls in place to ensure that the financial statements it files with the Commission are fairly presented. The company's declaration does not provide any additional, credible assurances that Absolute has remediated its internal controls.

Absolute argues that revocation "would only 'harm investors unfairly rather than serve any deterrent or remedial function now that the company has filed, albeit untimely, all its delinquent reports.'" The company asserts that, if the Commission revokes its registration, "delinquent registrants will not make the effort to become current . . . and investors in those companies will not obtain the relevant information." Moreover, Absolute contends that it "presented undisputed evidence that it would sustain substantial harm if the Initial Decision

³⁴ *Gately & Assoc., LLC*, Exchange Act Release No. 62656, 2010 WL 3071900, at *7 n.14 (Aug. 5, 2010) (citing *Anderson v. Liberty Lobby*, 477 U.S. 242, 247-48 (1986)).

³⁵ We are not persuaded by Absolute's vague representations that it will take "all necessary steps to ensure ongoing compliance," and that it has established "regular and reliable relationships with new accountants and auditors."

³⁶ See Item 308 of Regulation S-K (setting forth requirements for an issuer's disclosure of "internal control over financial reporting"), 17 C.F.R. § 229.308.

ordered revocation." For instance, the company asserts that "much of the time, effort and expense it put into becoming current would go to waste," which would harm shareholders. And it states that, "if [Absolute] were forced to begin the registration process again and file a new registration statement, it would have to spend additional money to do so, which would decrease shareholder value further."

We have held repeatedly, however, that "[t]he extent of any harm that may result to existing shareholders [from revocation] cannot be the determining factor in our analysis"; rather, "[i]n evaluating what is necessary or appropriate to protect investors, 'regard must be had not only for existing stockholders of the issuer, but also for potential investors.'"³⁷ All investors in the marketplace, both current and prospective, were deprived of timely reports that accurately reflect the company's financial situation and acknowledge its difficulties with internal controls. Moreover, it is necessary to deter Absolute and other issuers from disregarding their obligations to present accurate and timely information to the investing public until spurred by the institution of proceedings. Deterrence is meaningful only if a lengthy delinquency, in the absence of strongly compelling circumstances regarding the other *Gateway* factors, results in revocation. Thus, we apply a strong presumption in favor of revocation whereby a "recurrent failure to file periodic reports" is "so serious that only a strongly compelling showing with respect to the other factors we consider would justify a lesser sanction than revocation."³⁸ Absolute has failed to make the required showing, and the public interest requires revocation.

C. Contrary to Absolute's argument, Commission precedent does not preclude revocation under these circumstances.

Absolute incorrectly asserts that our precedent precludes revocation where an issuer has regained compliance before a law judge issues an initial decision, even where the issuer's compliance is spurred by the filing of an OIP. Although we have recognized that an issuer's subsequent attempts to file delinquent reports and remain in compliance with its reporting obligations are important factors to be considered in determining whether to revoke an issuer's securities registration, we have repeatedly stated that such subsequent filing history is not the determinative factor in this analysis.³⁹ For example, in *e-Smart Technologies, Inc.*, a

³⁷ *Gateway Int'l Holdings, Inc.*, 2006 WL 1506286, at *7; see also *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *14 (Nov. 4, 2013); *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *8 (June 29, 2012) (finding that "[r]evocation is a prospective remedy and is imposed based on our concern about protecting future investors in the company").

³⁸ *Impax Labs., Inc.*, Exchange Act Release No. 57864, 2008 WL 2167956, at *8 (May 23, 2008). *Accord Calais Res., Inc.*, Exchange Act Release No. 67312, 2012 WL 2499349, at *4 (June 29, 2012); *Cobalis Corp.*, Exchange Act Release No. 64813, 2011 WL 2644158, at *5 (July 6, 2011); *Am. Stellar Energy, Inc. (n/k/a Tara Gold)*, Exchange Act Release No. 64897, 2011 WL 2783483, at *4 (July 18, 2011).

³⁹ *e-Smart*, 2004 WL 2309336, at *2 n.18; *China-Biotics, Inc.*, 2013 WL 5883342, at *13.

Commission decision on which Absolute principally relies, we remanded proceedings to a law judge because a central premise underlying the law judge's decision to revoke—that the company was *unable* to submit audited reports—"no longer appeared valid." In doing so, we explained that our decision to remand was based on the particular facts of the case and "should not be construed as suggesting that a determination to revoke an issuer's registration will be reconsidered simply because the issuer [h]as returned to reporting compliance and begun to submit long overdue filings."⁴⁰ Rather, we noted, "[o]ther considerations . . . may justify a different result,"⁴¹ and we have since distinguished *e-Smart* on this basis.

As we have recognized, revocation may be warranted in these circumstances to address not only the harm to current and prospective investors in the non-compliant issuer but also to address the broader systemic harm that follows from registrants who "game the system" by complying with their unambiguous reporting obligations only when they are confronted by imminent revocation:

A sanction other than revocation would "reward those issuers who fail to file required periodic reports when due over an extended period of time" and "make last-minute filings [only after becoming the subject of Exchange Act Section 12(j) proceedings] in an effort to bring themselves current with their reporting obligations." Such conduct prolongs "indefinitely the period during which public investors would be without accurate, complete, and timely reports" and significantly detracts from the Exchange Act's reporting requirements.⁴²

In fact, we recently stated that "even if an issuer has filed all delinquent periodic reports, revocation can be appropriate, particularly when . . . the delinquencies continued for an extended period without adequate explanation."⁴³

In any event, *e-Smart* is distinguishable. In *e-Smart*, although the company had not made numerous filings for over two years, it produced evidence at the hearing before the law judge explaining the reasons behind these failures and the remedial measures it had subsequently taken to come into compliance and ensure future compliance—including retaining new securities counsel and auditors and implementing new internal accounting controls.⁴⁴ The company also

⁴⁰ 2004 WL 2309336, at *2 n.18. We did not hold, as Absolute suggests, that *e-Smart*'s subsequent filing history precluded revocation, nor did we hold that the law judge could not find revocation appropriate on remand.

⁴¹ *Id.* On remand, however, the law judge reversed her position and declined to revoke *e-Smart*'s registration. *e-Smart*, 2005 WL 274086, at *8.

⁴² *Tara Gold*, 2011 WL 2783483, at *7 nn. 30-32 (quoting *Nature's Sunshine Prods., Inc.*, Exchange Act Release No. 59268, 2009 WL 137145, at *8 (Jan. 21, 2009)).

⁴³ *China-Biotics, Inc.*, 2013 WL 5883342, at *13.

⁴⁴ *e-Smart*, 2004 WL 2309336, at *1.

represented that it would shortly begin to come into compliance. But the law judge concluded that the company would not be able to come into compliance and revoked its securities registration. We remanded because the law judge's conclusion proved incorrect—the company soon began to file its delinquent reports. Although we stated that e-Smart's post-OIP filing history was "an important factor to be considered in determining whether revocation is 'necessary or appropriate for the protection of investors,'"⁴⁵ we warned against interpreting our decision as a bright-line rule against revocation simply because a delinquent filer takes steps to become compliant.

Likewise, the undisputed facts that support our revocation of Absolute's securities registration are distinguishable from the circumstances in *Phlo Corp.*⁴⁶ There, the company failed to file eleven annual and quarterly reports between March 2003 and November 2005. Nonetheless, because the company made extensive and successful efforts to remedy the internal accounting failures that led to its violations, became current in its reporting obligations while the disciplinary proceeding was pending, and expended significant resources in so doing, we declined to revoke the company's securities registration and instead imposed a cease-and-desist order against future violations.⁴⁷

In *Phlo*, the issuer—unlike Absolute—pointed to specific internal accounting failures that led to its reporting violations and demonstrated concrete and effective corrective measures it had taken to address those circumstances. For example, the issuer retained a consultant recommended by its auditor to improve internal accounting functions. We determined that revocation was unwarranted in light of these considerations, when combined with the issuer's subsequent compliance. Here, Absolute's noncompliance was more protracted. And, as noted, it has failed to offer a meaningful explanation for its reporting violations or demonstrate that it has taken concrete, effective measures to remedy the cause of its reporting violations and ensure future compliance. In fact, Absolute's most recent reporting inaccuracies underscore our conclusion that it cannot ensure future compliance. The record demonstrates that Absolute failed to comply with its reporting requirements and only began to comply when spurred by the threat of imminent revocation. In these circumstances, the public interest requires that we revoke Absolute's securities registration.⁴⁸

⁴⁵ *Id.* at 2.

⁴⁶ Exchange Act Release No. 55562, 2007 WL 966943 (Mar. 30, 2007). Absolute does not refer to *Phlo Corp.*, but we address it here because we declined to revoke the respondent's registration.

⁴⁷ As we have noted elsewhere, the Exchange Act provides other remedies to address reporting violations, including ordering the company to cease-and-desist pursuant to Exchange Act Section 21C. *See e-Smart*, 2004 WL 2309336, at *2 n.17. The proceedings here, however, were instituted pursuant to Section 12(j), and thus are limited to the remedies provided thereunder.

⁴⁸ Absolute also relies on an administrative law judge's initial decision in which the law judge did not revoke an issuer's securities registration because it returned to compliance

(continued...)

We have stressed the "significant policy objectives" the reporting requirements "are intended to serve, *i.e.*, providing the public, particularly current and prospective shareholders, with material, timely, and accurate information about an issuer's business."⁴⁹ "Those requirements are 'the primary tool[s] which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities.'"⁵⁰ It would be contrary to the public interest to allow Absolute to continue to have its securities registered with the Commission when its conduct creates substantial reason to doubt that it will provide investors with timely, accurate, and material information in the future. Revoking Absolute's registration also will serve the public interest by deterring Absolute and other issuers from refusing to comply with the reporting requirements until they are threatened with imminent revocation by a Commission enforcement action.⁵¹ For the foregoing reasons, we find that revocation of the registration of Absolute's securities is necessary and appropriate in the public interest.

An appropriate order will issue.⁵²

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN, and PIWOWAR; Commissioner AGUILAR not participating).


Jill M. Peterson
Assistant Secretary

(...continued)

following the issuance of the order instituting proceedings. *Diatect Int'l Corp.*, Initial Decision Release No. 344, 2008 WL 247231, at *4-5 (Jan. 30, 2008). We are not bound by a law judge's initial decision, *see, e.g., Rapoport v. SEC*, 682 F.3d 98, 105 (D.C. Cir. 2012), and decline to apply the law judge's reasoning here. As we made clear in *Nature's Sunshine* and *Tara Gold*, revocation can be appropriate notwithstanding an issuer's return to compliance. *See supra* note 42 and accompanying text.

⁴⁹ *Am.'s Sports Voice*, 2007 WL 858747, at *4.

⁵⁰ *Eagletech Commc'ns, Inc.*, Exchange Act Release No. 54095, 2006 WL 1835958, at *3 & n.16 (July 5, 2006) (quoting *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977)).

⁵¹ As we have noted in similar cases, Absolute may file a Form 10 to re-register its securities under Exchange Act Section 12(g) as soon as it meets the applicable requirements under the form. 15 U.S.C. § 78l(g); *see also China-Biotics*, 2013 WL 5883342, at *14 n.97; *Cobalis Corp.*, 2011 WL 2644158, at *6 n.33.

⁵² We have considered all of the parties' contentions. We have rejected or accepted them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

Exhibit 1 - Absolute Potential, Inc. (File No. 3-14587)
Summary of Delinquent Filings for Period Charged in OIP

No.	Report	Period Ending	Due Date For Filing Report ⁵³	Delinquency Corrected	
				Date	How Late
01	10-K	09/30/2006	12/29/2006	12/16/2011	5 years, 0 months
02	10-Q	12/31/2006	02/14/2007	12/20/2011	4 years, 10 months
03	10-Q	03/31/2007	05/15/2007	12/21/2011	4 years, 7 months
04	10-Q	06/30/2007	08/14/2007	12/21/2011	4 years, 4 months
05	10-K	09/30/2007	12/31/2007	12/23/2011	4 years, 0 months
06	10-Q	12/31/2007	02/14/2008	12/27/2011	3 years, 10 months
07	10-Q	03/31/2008	05/15/2008	12/27/2011	3 years, 7 months
08	10-Q	06/30/2008	08/14/2008	12/27/2011	3 years, 4 months
09	10-K	09/30/2008	12/29/2008	12/28/2011	3 years, 0 months
10	10-Q	12/31/2008	02/17/2009	12/29/2011	2 years, 10 months
11	10-Q	03/31/2009	05/15/2009	12/29/2011	2 years, 7 months
12	10-Q	06/30/2009	08/14/2009	12/29/2011	2 years, 4 months
13	10-K	09/30/2009	12/29/2009	12/29/2011	2 years, 0 months
14	10-Q	12/31/2009	02/16/2010	12/29/2011	1 year, 10 months
15	10-Q	03/31/2010	05/17/2010	12/30/2011	1 year, 7 months
16	10-Q	06/30/2010	08/16/2010	12/30/2011	1 year, 4 months
17	10-K	09/30/2010	12/29/2010	01/06/2012	1 year, 0 months
18	10-Q	12/31/2010	02/14/2011	01/06/2012	0 years, 11 months
19	10-Q	03/31/2011	05/16/2011	01/06/2012	0 years, 8 months
20	10-Q	06/30/2011	08/15/2011	01/06/2012	0 years, 5 months

⁵³ Non-accelerated filers, such as Absolute, are required to file quarterly and annual reports with the Commission no later than 45 days and 90 days, respectively, after the end of the period covered by the report. Exchange Act Rule 13a-13 and General Instruction A.1. to Form 10-Q; 17 C.F.R. § 240.13a-13 and 17 C.F.R. § 249.308a; Exchange Act Rule 13a-1 and General Instruction A.2 to Form 10-K; 17 C.F.R. § 240.13a-1 and 17 C.F.R. § 249.310.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71866 / April 4, 2014

Admin. Proc. File No. 3-14587

In the Matter of

ABSOLUTE POTENTIAL, INC.
(f/k/a Absolute Waste Services, Inc.)
c/o Randall D. Lehner, Esq.
Ulmer Berne LLP
500 West Madison Street, Ste. 3600
Chicago, IL 60661-4587

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that the registration of all classes of the registered securities of Absolute Potential, Inc. (f/k/a Absolute Waste Services, Inc.) under Section 12(g) of the Securities Exchange Act of 1934 is hereby revoked pursuant to Exchange Act Section 12(j).

By the Commission.


Jill M. Peterson
Assistant Secretary

*Chair White
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71882 / April 4, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-11579

In the Matter of

INVIVA, INC. AND
JEFFERSON NATIONAL LIFE
INSURANCE COMPANY,

Respondents.

ORDER AUTHORIZING THE TRANSFER
OF REMAINING FUNDS AND ANY
FUTURE FUNDS RETURNED TO THE
FAIR FUND TO THE U.S. TREASURY,
DISCHARGING THE FUND
ADMINISTRATOR AND TERMINATING
THE FAIR FUND

On August 9, 2004, the Commission issued an Order instituting and simultaneously settling public administrative and cease-and-desist proceedings (the "Order") against Inviva, Inc. ("Inviva") and Jefferson National Life Insurance Company ("Jefferson National") (collectively, "Respondents") in this matter.¹ In the Order, the Commission found that from around October 2002 through September 2003, the Respondents allowed a group of hedge funds and customers of registered representatives to engage in market timing trading on behalf of Jefferson National variable annuity contract owners. The Order established a Fair Fund, comprised of \$5 million in disgorgement and penalties paid by Respondents, and provided that the Fair Fund was to be distributed pursuant to a plan developed by an Independent Distribution Consultant. On February 26, 2010, the Commission issued an order approving the distribution plan.²

The Plan of Distribution ("Plan") provides that the Fair Fund, plus any accrued interest, minus taxes, fees, and expenses, be distributed by the Fund Administrator to investment company portfolios harmed by the market timing activity, according to the methodology set forth in the Plan. On June 4, 2010, the Commission entered an order directing disbursement of \$5,461,603.97,³ and on June 17, 2010 this amount was distributed to the twenty-three (23) eligible investment company portfolios. All distributions have been made to and accepted by the funds, and no amounts were returned to the Fair Fund.

¹ See Securities Act Release No. 8456 (Aug. 9, 2004).

² See Exchange Act Release No. 61600 (Feb. 26, 2010).

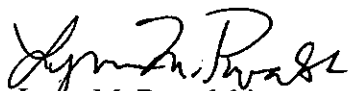
³ See Exchange Act Release No. 62228 (Jun. 4, 2010).

The Plan provides that the Fair Fund shall be eligible for termination, and the Fund Administrator shall be discharged, after all of the following have occurred: (1) a final accounting has been submitted by the Fund Administrator and approved by the Commission; (2) all taxes, fees and expenses have been paid, and (3) any amount remaining in the Fair Fund has been received by the Commission. A final accounting, which was submitted to the Commission for approval as required by Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans and as set forth in the Plan, is now approved. Staff has verified that all taxes, fees, and expenses have been paid, and the Commission is in possession of the remaining Fair Fund monies.

Accordingly, IT IS ORDERED that:

- A. The remaining Fair Fund balance of \$157.92 and any future funds returned to the Fair Fund shall be transferred to the U.S. Treasury;
- B. The Fair Fund is terminated; and
- C. The Fund Administrator, William Randolph Thompson, is discharged;

By the Commission.


Lynn M. Powalski
Deputy Secretary

*Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9572 / April 7, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71885 / April 7, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3811 / April 7, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31008 / April 7, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15617

In the Matter of

LARRY C. GROSSMAN
and GREGORY J. ADAMS,

Respondents.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER PURSUANT
TO SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
SECTIONS 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940, AND ORDERING
CONTINUATION OF PROCEEDINGS
AGAINST GREGORY J. ADAMS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Company Act") and Ordering Continuation of Proceedings against Gregory J. Adams ("Adams").¹

¹ On November 20, 2013, the Commission instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Company Act, against Adams and co-respondent, Larry C. Grossman ("Grossman").

II.

Adams has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Adams consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 and Ordering Continuation of Proceedings Against Gregory J. Adams ("Order"), as set forth below.

III.

On the basis of this Order and Adams' Offer, the Commission finds that:²

A. RESPONDENTS

1. Grossman, age 58, resides in Tarpon Springs, Florida, and was the founder, managing partner, and sole owner of Sovereign International Asset Management, Inc. ("Sovereign") until October 2008, when he sold Sovereign, along with related entities, to Adams. Grossman is currently the principal manager of Sovereign International Pension Services, Inc., an IRA administrator ("SIPS").

2. Adams, age 58, resides in Palm Harbor, Florida and was Sovereign's managing partner and owner from October 2008 to its dissolution. Adams bought Sovereign, along with other related entities, from Grossman in October 2008. He currently owns and manages Sovereign Private Wealth, Inc., an investment adviser that was registered with the Commission until December 17, 2012 (at which point it had approximately \$15 million in assets under management). Adams is the managing director of Weybridge Capital, which manages the Sheffield family of funds registered and licensed in the British Virgin Islands. On May 15, 2013, Adams filed a Chapter 7 bankruptcy petition.

B. OTHER RELEVANT ENTITIES AND INDIVIDUALS

3. Sovereign International Asset Management, Inc. ("Sovereign"), a Florida corporation with its principal place of business in Clearwater, Florida, was incorporated by Grossman in 2001. Sovereign registered with the Commission as an investment adviser on June 21, 2002. In October 2008, Grossman sold Sovereign to Adams. At all relevant times, Sovereign was owned, managed, and controlled solely by either Grossman or Adams. On June 28, 2012, Sovereign filed for Chapter 7 bankruptcy

² The findings herein are made pursuant to Adams' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

in the United States Bankruptcy Court for the Middle District of Florida. Sovereign was administratively dissolved by the State of Florida at the end of September of 2012. Pursuant to Section 203(h) of the Advisers Act, the Commission canceled Sovereign's registration on February 6, 2013.

4. Sovereign International Asset Management, LLC ("SIAM, LLC") is a limited liability company Grossman formed in April 1999 and registered in Anguilla. Grossman sold SIAM, LLC to Adams in conjunction with the sale of Sovereign in October 2008.

5. Anchor Holdings, LLC (Florida) ("AH Florida") is a limited liability company registered in Florida in 2005. Grossman sold AH Florida to Adams in October 2008. It was dissolved in September 2012.

6. Anchor Holdings, LLC (Nevis) ("AH Nevis") is a company Grossman formed and registered in Nevis in September 2004. Grossman sold AH Nevis to Adams in conjunction with the sale of Sovereign in October 2008.

7. Nikolai Simon Battoo ("Battoo"), age 41, is the principal of BC Capital Group, S.A. (Panama) and BC Capital Group Limited (Hong Kong), collectively referred to herein as "BC Capital." Through BC Capital, Battoo operates offshore hedge funds. He also offers managed account services through Private International Wealth Management ("PIWM"). Battoo is not registered with the Commission in any capacity. Battoo was named as a defendant in a fraud action the Commission filed on September 6, 2012, SEC v. Nikolai S. Battoo, et al., 12CV7125, N.D. Ill.

8. Anchor Hedge Fund Limited ("Anchor Hedge Fund") was incorporated in the British Virgin Islands in September 2002. Grossman was a consultant to Anchor Hedge Fund and, along with Battoo, a member of its investment advisory board until at least July 2008.

9. Anchor Hedge Fund Management Limited ("AHF Management"), formed in Hong Kong in 2004, was the investment manager of Anchor Hedge Fund.

C. BACKGROUND

1. Sovereign's Operations

10. Sovereign was an investment adviser registered with the Commission since June 2002. At its peak in 2008, Sovereign reported it had \$85 million in assets under management. Sovereign was a small organization run by Grossman, Sovereign's sole control person, until Grossman sold it to Adams in October 2008. Sovereign employed a small staff of less than ten people. No one at Sovereign was a registered representative associated with a broker-dealer during the relevant period.

11. Sovereign targeted retirees seeking to invest their money offshore, and most of Sovereign's clients were retired individuals with self-directed IRAs. In its

promotional materials, Sovereign represented to clients that it "use[d] an extensive investment selection process that [was] not only qualitative but incorporate[d] a significant due diligence process as well." In fact, Sovereign and Adams advised their clients to invest almost exclusively in funds and accounts managed or controlled by Battoo, regardless of their clients' investment objectives.

12. Specifically, Sovereign and Adams recommended that their clients invest and remain invested almost exclusively in several of Battoo's offshore funds: Anchor Hedge Fund Classes A, B, C and E (the "Anchor Funds"); FuturesOne Diversified Fund Ltd., ("FuturesOne") a mutual fund formed in the British Virgin Islands (Battoo was the sole member and Chairman of its investment advisory board) (collectively, the "Battoo Funds"); and in PIWM, a managed account.

2. Grossman Forms AH Florida

13. Grossman formed AH Florida in 2005, using the identical name of another entity he had formed in Nevis a year before. Sovereign, through Adams (after he acquired AH Florida), instructed clients seeking to invest in the Battoo Funds and PIWM to transfer their money to AH Florida's account at a bank in Florida. Sovereign gave clients a document called "Anchor Hedge Fund Application for Shares," in which AH Florida was identified as an intermediary, and also included a wire transfer form authorizing a transfer to AH Florida's account. But Adams never told clients, either in writing or orally, that Sovereign would pool client funds into a bank account in the name of AH Florida, an entity owned by Adams. Clients completed an application for the individual shares they wanted to purchase.

14. After pooling client funds in AH Florida's bank account, Adams transferred the funds offshore to the Battoo Funds and PIWM in the name of AH Nevis. Because of the similarity in names, clients believed that the AH Florida account was an account belonging to Anchor Hedge Fund. Although Adams gave Battoo the names of the clients investing in his funds, the investments were nevertheless made in the name of AH Nevis, which was owned by Adams.

15. Sovereign's clients never received statements from a qualified custodian or from Sovereign regarding the investment funds deposited in AH Florida's bank account. Although Sovereign sent statements to clients regarding their purported investments in the Battoo Funds, there were no surprise annual exams of Sovereign during the relevant period.

3. Grossman Sells Sovereign to Adams

16. On October 1, 2008, Grossman sold Sovereign to Adams. On October 14, 2008, Adams emailed a letter signed by Grossman to Sovereign clients—most of whom had invested exclusively in the Battoo Funds and PIWM—in which Grossman wrote that he "want[ed] to reiterate that our hedge fund investments are 'Fund of Funds' that are highly diversified with different managers, styles and strategies."

17. The letter introduced Adams and informed clients that Adams had been named Sovereign's President and Chief Investment Officer. The letter stated Grossman would remain Managing Director of SIPS, which was "only a few doors from [Adams'] office." He would also remain on Sovereign's Board of Advisers and was "actively involved in the day-to-day strategy development as needed."

D. ADAMS'S MISSTATEMENTS AND OMISSIONS TO INVESTORS

1. Misstatements and Omissions about Compensation

18. On January 17, 2003, Sovereign sent an email to its clients stating that Sovereign had taken on an active role as an investment adviser to Battoo's Anchor Hedge Fund. Sovereign represented to its clients that it received no additional compensation but was "privy to and part of many investment decisions that are made."

19. More so than an investment adviser to Anchor Hedge Fund, Sovereign was a referral source for Battoo and his offshore funds. Adams, from October 2008 until August 2010, advised Sovereign's clients to invest or remain invested almost exclusively in the Battoo Funds and PIWM.

20. Sovereign's clients invested primarily in Anchor Funds, which was a fund of funds, and PIWM. Thus, Sovereign's clients paid multiple layers of fees when they invested in Anchor Funds. Sovereign's clients, however, received little or no additional benefits in exchange for these extra fees. For example, they did not receive any meaningful diversification across different fund manager styles as is typically offered by a fund of funds because many of Anchor Funds' sub-funds were managed, controlled, or advised by Battoo. Like those clients who invested in Anchor Funds, clients who invested in PIWM also paid fees on fees because PIWM invested in sub-funds that were managed, controlled, or advised by Battoo.

a. The Referral and Consulting Agreements

21. From August to December 2003, Grossman signed three referral and one consulting agreements, on behalf of SIAM, LLC, with funds and entities Battoo owned or controlled: (1) a referral agreement between SIAM, LLC and Anchor Hedge Fund (the "Anchor Referral Agreement"); (2) a referral agreement between SIAM, LLC and FuturesOne (the "FuturesOne Referral Agreement"); (3) a referral agreement between SIAM, LLC and BC Capital Group S.A. (Panama), which managed the PIWM account (the "PIWM Referral Agreement"); and (4) a consulting agreement between Grossman and Anchor Hedge Fund's investment manager (the "Consulting Agreement").

22. The first three of these agreements triggered referral fees to Sovereign, paid to SIAM LLC. Adams did not disclose this compensation to the Sovereign investors.

23. The four written agreements included: (a) the Anchor Referral Agreement, effective August 1, 2003, pursuant to which Anchor Hedge Fund paid SIAM,

LLC a 1% sales load for Anchor Hedge Fund Classes A and B and a 2% sales load for Anchor Hedge Fund Classes E and I; (b) the FuturesOne Referral Agreement, effective September 1, 2003, pursuant to which FuturesOne paid SIAM, LLC for each referred investor a 2% sales load and 50% of fees earned by Innovative Financial Holdings Limited ("Innovative"), the investment manager of FuturesOne; (c) the PIWM Referral Agreement, effective November 1, 2003, pursuant to which BC Capital Group, S.A. (Panama) agreed to pay SIAM, LLC 50% of the 1%-2% annual fee the advisor earned in PIWM; and (d) the Consulting Agreement, effective December 1, 2003, pursuant to which AHF Management paid Grossman a percentage of the management fee charged by Anchor Hedge Fund and a performance fee related to new net profits.

24. A fourth referral agreement, not in writing, between Anchor Hedge Fund and SIAM LLC, provided that SIAM LLC would receive the initial sales load of 4.5% charged to Sovereign's clients upon their investments in Anchor Hedge Fund and in PIWM. Anchor Hedge Fund made these payments in lump sums.

25. Pursuant to these agreements, beginning at least in 2004, Battoo paid Sovereign through SIAM, LLC's account in Denmark for referrals of clients to the Battoo Funds and PIWM. After the sale of Sovereign to Adams, and continuing through 2010, Battoo continued to pay Sovereign through SIAM, LLC, now owned by Adams:

b. Adam's Misrepresentations and Omissions
Concerning the Referral and Consulting Agreements

26. While he was a control person of Sovereign, Adams misrepresented compensation he received from Battoo related entities and thus failed to adequately disclose his conflicts of interest to Sovereign's clients.

27. For example, Sovereign did not timely provide the Form ADV Part II to all its clients as required under Advisers Act Rule 204-3 and its clients did not otherwise consent to delivery through a website. Further, the Form ADV Part II either omitted, or contained misleading statements regarding additional compensation. Sovereign also represented that it would notify clients of any and all fees paid to Sovereign. Yet, Sovereign failed to provide any notice to its clients of the fees paid to Grossman and SIAM, LLC.

28. Sovereign's Form ADV Part 1 was also misleading, even after Adams purchased Sovereign in October 2008. Although Sovereign for the first time disclosed in its 2009 Form ADV Part 1, under "Compensation Arrangements," its referral fees, that disclosure was misleading. For example, the disclosure was made in response to questions on the form about Sovereign's advisory business as opposed to more specific questions intended to elicit information about Sovereign's involvement in other business activities which could create potential conflicts of interest.

29. For many years, Sovereign's investment advisory agreements ("IAA") were also misleading and failed to contain any disclosures regarding the receipt of transaction-based compensation. Like the Form ADV Part II, the IAA explicitly stated that

Sovereign "will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Advisor." Sovereign gave this IAA to clients at the same time that it received compensation for referring its clients to Battoo. Yet, Sovereign did not disclose these fees to clients.

30. In August 2006, Sovereign revised its IAA and disclosed that Sovereign "may receive performance-based compensation from certain investment companies." However, this language did not provide adequate notice because it does not cover transaction-based compensation, such as referral fees to Sovereign or SIAM, LLC for recommending that clients invest in certain funds.

Misrepresentations and Omissions about Compensation
During Adams's Ownership

31. During Adams's ownership of Sovereign, the company made the following misleading disclosures about compensation:

(a) Sovereign's 2009 IAA stated that "[t]he Advisor [Sovereign] may receive performance-based compensation from certain investment companies." This disclosure was misleading because (i) it omitted the fact that SIAM, LLC (which was under common control with Sovereign) received referral fees (sales load and management fees) from Anchor Hedge Fund and FuturesOne, and referral fees (management fees) from BC Capital related to PIWM; and (ii) it did not disclose that SIAM, LLC received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients;

(b) Sovereign's 2009 IAA also stated that Advisor [Sovereign] will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Advisor." This disclosure was misleading because Sovereign never notified its clients that it was in fact receiving compensation, through SIAM, LLC, for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital;

(c) Sovereign's 2009 and 2010 Forms ADV Part II (and brochures) stated that "Sovereign may receive incentive or subscription fees from certain investment companies." This disclosure was misleading because it omitted the fact that SIAM, LLC was already receiving referral fees from Anchor Hedge Fund, FuturesOne, and BC Capital;

(d) Sovereign's 2009 and 2010 Forms ADV Part II (and brochures) further stated that "Sovereign will notify clients in advance of any investments the nature of any and all fees charged to the client and/or paid to Sovereign." The third disclosure was misleading because Sovereign never notified its clients that it was in fact receiving compensation, through SIAM, LLC, for referring them to Anchor Hedge Fund, FuturesOne, and BC Capital;

(e) Sovereign also stated the following in its brochure: (i) in Item 13, that Sovereign (or a related person) did not have an arrangement whereby it is paid cash

or received an economic benefit (including commissions, equipment, or non-research services) from a non-client in connection with giving advice to clients; (ii) in Item 8, that Sovereign did not have an arrangement with an investment company that was material to its advisory business or its clients; and (iii) in Item 9, that Sovereign (or a related person) did not recommend to clients that they buy or sell securities or investment products in which the applicant or a related person has some financial interest. These disclosures were misleading because (i) SIAM, LLC received referral fees from Anchor Hedge Fund, FuturesOne and BC Capital when Sovereign recommended investments in these funds and in a managed account to its clients; (ii) Sovereign did not disclose that SIAM, LLC received the initial 4.5% sales load Anchor Hedge Fund and PIWM charged to Sovereign's clients; and (iii) Grossman (a related person) was in fact receiving advisory fees (based upon a percentage of management and performance related fees) from AHF Management; and

(f) Sovereign's 2009 and 2010 Form ADV Part 1 stated in Item 5 (Information About Your Advisory Business-Compensation Arrangements) that "Sovereign receives referral fees for selection of other advisers." This disclosure was misleading because it did not disclose Sovereign's compensation arrangements with Anchor Hedge Fund, FuturesOne, and BC Capital Group, and because the statement was made in response to questions on the form about Sovereign's advisory business as opposed to more specific questions intended to elicit information about Sovereign's involvement in other business activities which could create potential conflicts of interest, such as Item 6.B.1. (Other Business Activities).

2. Adams Misled Clients to Invest In Anchor Hedge Funds

32. In or around October 2008, Adams advised clients to retain their investments in Anchor Hedge Fund. However, Adams knowingly or recklessly misrepresented the risk and independence of the funds.

a. Cross Portfolio Liability

33. After purchasing Sovereign, Adams told clients to retain their investments in the Battoo Funds (and Anchor Hedge Fund in particular) and PIWM. Written materials, including PPMs, described Anchor Fund Classes A and B to clients as moderately risky investments with goals of long-term capital appreciation and preservation. These classes, however, were subject to high risk. In fact, the assets of each class were available to meet the liabilities of the other classes, something that was not disclosed in the PPM. As a result, the investments in market neutral Anchor Classes A and B could be used to cover liabilities, including claims by investors and third parties, incurred by the higher risk and more volatile Anchor Class C. Sovereign did not disclose the exposure between the classes to clients who sought only moderately risky investments.

b. Anchor Hedge Fund Class A Did Not Invest in Diversified, Independently-Administered, and Audited Funds

34. According to its 2005 PPM, Class A invested into "a portfolio of well-established independently administered and audited hedge funds to be used to access the [fund's] investment objectives."

35. The PPM also stated that Class A invested into a portfolio of market neutral equity hedge investing and other alternative investments funds, "including funds investing both long and short in public equity investments and indexes, both in the USA and globally; with underlying holdings generally including but not being limited to bank deposits, fixed income securities, spot and forward foreign exchange contracts, equities, exchange traded funds, options, derivatives, government and corporate debt and other financial instruments." The PPM also stated that Class A would be administered by Folio Administrators, Ltd., but omitted to disclose that this entity was closely affiliated with Battoo and thus was not independent. For instance, its director was also on BC Capital's board and on Anchor Hedge Fund's professional advisory board.

36. In addition to written misstatements, Adams orally told clients in November 2008 that Anchor A was extremely safe and a "good place" to be.

37. In fact, Anchor Fund Class A did not invest in independently administered and audited hedge funds. Indeed, the asset verification reports came from parties related to Battoo, not from independent third parties. Anchor Hedge Fund's administrator generated the asset verification reports based on information provided by the custodian for Battoo and BC Capital. The administrator and custodian were controlled and managed by the same individuals who managed and administered Battoo's funds. They also shared the same post office boxes as Anchor Hedge Fund and signed the referral and consulting agreements with SIAM, LLC and Grossman.

38. The investments in Anchor Fund Class A were also far from diversified. Class A did not invest in what its PPM represented, such as fixed income securities, exchange traded funds, or government and corporate debt. In fact, after Battoo suspended redemptions for investments in Anchor Fund Class A in December 2008, he claimed Anchor Fund Class A had invested substantially all of its assets with Bernard Madoff.

39. During the relevant period, Adams continued to advise clients to retain their investments in Anchor A, even after (1) the suspension called into question Battoo's previous representation to Adams that only 2% of the fund had exposure to the Madoff Ponzi scheme and (2) Battoo refused to file a proof of claim or provide Adams with supporting documentation of the fund's investments.

c. Liquidity Issues with and Suspension of Anchor Fund Class C

40. Shortly before the Madoff scandal erupted in the press, Anchor Hedge Fund suspended redemptions of Anchor Fund Class C. On October 13, 2008,

Anchor Hedge Fund sent a letter to its Class C shareholders, notifying them that it was suspending redemptions of Anchor Fund Class C because it was switching its portfolio from one bank to another. This supposed change began at the end of 2007 but was delayed because of "deteriorating financial market conditions." The letter also stated that Anchor Hedge Fund would "begin processing redemptions as soon as it is practical."

41. After Anchor Hedge Fund suspended redemptions of Anchor C shares, Adams did not question the reason for the suspension. Instead, Adams simply accepted Battoo's assurances and represented to Sovereign's clients in writing that the suspension was due to Société Générale's failure to timely process a transfer of the custodial relationship for Anchor Fund C. A few weeks after the suspension, Battoo met with Adams and proposed exchanging Class C shares for PIWM shares. Shortly thereafter, Adams recommended the swap to Sovereign's clients without conducting sufficient due diligence concerning PIWM.

3. Adams's Misstatements and Omissions Regarding the PIWM Swap

42. Battoo proposed the swap shortly after Anchor Hedge Fund suspended redemptions of Class C shares. On October 28, 2008, Battoo visited Sovereign's offices and met with Adams. At this meeting, Battoo offered to exchange interests in PIWM's "Market Neutral" managed account for Sovereign clients' investments in shares of Anchor Hedge Fund Classes B, C, and E and in FuturesOne. By October 2008, these funds in Anchor Hedge Fund and FuturesOne had become illiquid or had substantially decreased in value.

43. Under the terms of the swap, Sovereign investors were to receive an interest, or an equivalent value-in-kind participation, in PIWM valued at amounts equal to the pre-impairment values of their hedge fund shares. In exchange, Battoo demanded a lock up period of 18 months. Nevertheless, Adams said the swap was advisable because he believed PIWM "Market Neutral" was similar to Anchor Class A which was a market neutral fund that had supposedly performed well in the past.

44. Although Adams had served on PIWM's advisory board since October 2008 he failed to conduct any due diligence concerning PIWM's investments before recommending the swap to Sovereign's clients. Had he done so, he would have known that PIWM's investments were almost entirely in funds and accounts managed or controlled by Battoo, including the funds being exchanged in the swap.

45. Rather than conduct independent due diligence about PIWM's investments, Adams simply requested more information from Battoo, which Battoo refused to provide. Nevertheless, Adams, who received referral fees from PIWM, signed the swap agreement and recommended the swap to Sovereign's clients. More specifically, Adams recommended that Sovereign clients swap their Anchor Class C shares for PIWM managed account interests using an account value as of August 31, 2008. Furthermore, Adams assured clients who invested in Anchor C that the swap was "a generous offer in light of a situation [Battoo] did not create."

46. In November, 2008, Adams further represented to Sovereign clients that: (1) the suspension of Anchor C was due to Société Générale's failure to process the transfer of the custodial relationship for Anchor Class C; (2) PIWM had much better performance than Anchor Class C and, by exchanging the shares, clients would avoid the losses incurred in September and October 2008; and (3) The resulting interests in PIWM were subject to an 18 month lock-up.

47. Before Adams executed the swap agreement on January 30, 2009, Adams failed to disclose to clients that: (1) underlying investments for PIWM were in other funds almost all managed or controlled by Battoo, including Anchor and FuturesOne, and thus there was no diversification of management style and no reason to expect better investment performance; (2) PIWM's sub-funds were illiquid and suspended purportedly due to the Madoff Ponzi scheme (including Anchor Class A and Galaxy Fund Class C) or had incurred such significant losses that the sub-fund was also being exchanged for PIWM (Anchor Class E).

48. On January 30, 2009, three months after Battoo proposed the swap and almost two months after Battoo suspended redemptions of Anchor Class A purportedly due to the Madoff scandal, Adams executed an agreement in which AH Nevis transferred to PIWM its shares of Anchor Hedge Fund (all classes except for A) and of FuturesOne.

49. Later, in the fall of 2009, a year after the swap was proposed by Battoo, Adams was still receiving vague and conflicting responses from Battoo as to the start date of the lock up period and whether it was 18 months or 24 months. Despite this disagreement, Adams continued to advise clients to retain their investments in the Battoo Funds and PIWM.

50. Beginning in 2010, Battoo refused to permit withdrawals from PIWM, in part because of a dispute over the lock-up period. In November 2011, Battoo publicly claimed to investors that losses incurred in the MF Global bankruptcy triggered the refusal to permit withdrawals from PIWM.

E. ADAMS IGNORED RED FLAGS

51. Before the suspensions of the Battoo Funds and the PIWM swap agreement, Adams failed adequately to research or investigate a number of red flags about Battoo and his funds.

52. According to Anchor Hedge Fund PPMs, shareholders were entitled to receive annual audited financial reports upon request. However, in 2008 Adams knew Battoo ceased providing to investors independently-audited financial statements regarding the Battoo Funds. The last independent auditor report Sovereign received from Anchor Hedge Fund for Anchor Class C was for the year ended December 31, 2006 and for Anchor Classes A and B was for the year ended December 31, 2007. Battoo did not provide any other audited financial statements and told Adams he would not because the information was confidential and proprietary. Nevertheless, Sovereign, and Adams continued to recommend Battoo's funds to their clients.

53. Anchor Hedge Fund PPMs also entitled investors to receive asset verification reports from independent third parties upon request. However, Adams knew asset verification reports came from parties related to Battoo, not from independent third parties. The reports were generated by Anchor Hedge Fund's administrator and based on information provided by the custodian for Battoo and BC Capital. The administrator and custodian were controlled and managed by the same individuals who managed and administered Battoo's funds and shared the same post office boxes as Anchor Hedge Fund and PIWM. In addition, these individuals signed the referral and consulting agreements with SIAM, LLC. Despite this lack of independence, undisclosed to investors, Adams failed to investigate the figures Battoo provided to him. Instead, he touted the performance of the Battoo Funds to Sovereign clients.

54. Finally, Adams failed independently to investigate Anchor Hedge Fund even after Battoo suspended redemptions of Anchor Class A and subsequently refused to file a claim in the Madoff recovery proceedings or provide information regarding its losses.

F. VIOLATIONS

55. As a result of the conduct described above, Adams willfully violated Section 17(a) of the Securities Act which prohibits fraudulent conduct in the offer and sale of securities.

56. As a result of the conduct described above, Adams willfully violated Section 15(a) of the Exchange Act, which prohibits an unregistered broker-dealer from making use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, and willfully aided and abetted and caused violations of Section 15(a) of the Exchange Act.

57. As a result of the conduct described above, Adams willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by investment advisers and impose on investment advisers a fiduciary duty to act in "utmost good faith," to fully and fairly disclose all material facts, and to use reasonable care to avoid misleading clients.

58. As a result of the conduct described above, Adams willfully violated Section 206(3) of the Advisers Act, which prohibits an investment adviser from "acting as a broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client . . . without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

59. As a result of the conduct described above, Adams willfully aided and abetted and caused violations of Section 206(4) of the Advisers Act, which prohibits fraudulent, deceptive, or manipulative conduct by an investment adviser, and Rule 206(4)-2 promulgated thereunder, which requires that an investment adviser maintain each client's

funds in bank accounts containing only those client funds, notify its clients as to the name and address of the custodian of client funds and manner in which their funds are maintained, and have client funds and securities verified by an independent public accountant at least once a year without prior notice to the investment adviser.

60. As a result of the conduct described above, Adams willfully aided and abetted and caused violations of Rule 204-3 of the Advisers Act, which requires investment advisers to deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Part II of Form ADV.

61. As a result of the conduct described above, Adams willfully violated Section 207 of the Advisers Act which makes it unlawful "for any person willfully to make any untrue statements of material fact in any registration application or report filed with the Commission under Section 203 or 204.

IV.

Pursuant to this Order, Adams agrees that disgorgement and third tier civil penalties are appropriate, and further agrees to additional proceedings in this proceeding to determine the amount of such disgorgement and civil penalties, plus prejudgment interest if ordered, pursuant to Section 8A of the Securities Act, Sections 21B and 21C of the Exchange Act, Sections 203(i) and 203(j) of the Advisers Act, and Sections 9(d) and 9(e) of the Company Act. In connection with such additional proceedings, Adams agrees: (a) he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of this Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors to impose the sanctions agreed to in Adams' Offer, and to continue proceedings to determine the amount of disgorgement and civil penalties.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Company Act, it is hereby ORDERED that:

A. Adams cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act; Section 15(a) of the Exchange Act; and Sections 206(1), 206(2), 206(3), 206(4) and 207 of the Advisers Act and Advisers Act Rules 204-3 and 206(4)-2.

B. Adams be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter

C. Any reapplication for association by Adams will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Adams, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Adams shall pay disgorgement and third tier civil penalties, in amounts to be determined by additional proceedings.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9573 / April 8, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71896 / April 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3548 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15825

In the Matter of

LAIRD DANIELS, CPA,

Respondent.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND
CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933,
SECTIONS 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
AND RULE 102(e) OF THE
COMMISSION'S RULES OF PRACTICE,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Laird Daniels ("Respondent" or "Daniels") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public

Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. SUMMARY

In the third quarter of 2009, CVS Caremark Corporation ("CVS") dramatically and without public disclosure changed its accounting for 525 Longs drugstores that had been acquired in October 2008. CVS improperly reduced the value of \$189 million of personal property in the Longs stores down to \$0. CVS then reversed \$49 million of depreciation that had been taken on those assets since the acquisition. The undisclosed depreciation reversal increased third-quarter 2009 earnings per share ("EPS") by approximately 2.4¢, enabling CVS to exceed analysts' expectations at a time when it was announcing a significant reduction in its earnings projections for 2010. With proper accounting, the asset write-down would have been treated as a current-period expense, and third-quarter 2009 EPS would have been reduced by as much as 17% (as much as 9.3¢).

Respondent Daniels, then the Retail Controller at CVS, orchestrated the improper accounting adjustment, causing CVS to value at \$0 all the personal property in approximately 430 of the 525 Longs stores, including more than 360 stores that CVS was going to operate for the long term. In Daniels' own words, CVS's accounting turned the acquisition of the Longs drugstores from a "bad guy" into a "good guy."

B. RESPONDENT

Daniels is 44 years old and lives in North Attleboro, Massachusetts. He is licensed in Connecticut as a certified public accountant. Prior to May 2009, he was Vice President for Corporate Budgeting at CVS, with responsibility for preparing budgets and forecasts for its retail pharmacy business. In May 2009, he became Retail Controller, with responsibility for collecting financial information from units within the retail pharmacy business and supervising the preparation of budgets, actual financial results, and forecasts. In January 2010, he became Chief Accounting Officer, with responsibility for the consolidation of financial information for all segments of CVS. He is currently the Senior Vice President for International Operations and Business Development at CVS.

C. OTHER RELEVANT ENTITY

CVS is a Delaware corporation with its principal executive offices in Woonsocket, Rhode Island. Its common stock is traded on the New York Stock Exchange under the symbol "CVS." It operates a nationwide chain of more than 7,400 drugstores and currently ranks #13 on the Fortune 500 list, with more than \$120 billion of revenue in 2012.

D. DANIELS ORCHESTRATED IMPROPER ADJUSTMENTS TO THE ACCOUNTING FOR THE LONGS ACQUISITION

Introduction

1. On October 20, 2008, CVS acquired the Longs chain of approximately 525 drugstores. CVS hired a major accounting firm to prepare a valuation for the Longs purchase price accounting ("PPA") under Statement of Financial Accounting Standards ("SFAS") 141 ("Business Combinations").¹ On January 27, 2009, the valuation firm submitted a draft report. As required by its contract with CVS, the valuation firm applied a "continued use" premise – that CVS would retain and continue using all of the Longs stores' property, plant and equipment (except for stores to be closed, as identified by CVS). The firm valued the Longs stores' property, plant and equipment at more than \$1.2 billion, including \$937 million of real property and \$229 million of personal property. The valuation results were included in CVS's audited financial statements for the fiscal year ended December 31, 2008, which were incorporated by reference in the annual report on Form 10-K that CVS filed with the Commission on February 27, 2009.

2. After accounting for the Longs PPA in its financial statements for 2008 and the first and second fiscal quarters of 2009, CVS, through Daniels, improperly adjusted the way the Longs PPA was accounted for and included the improper adjustments to the Longs PPA in later financial statements filed in November 2009. The result of this change was to boost CVS's financial results for its quarter ended September 30, 2009 (its third quarter).

3. On November 5, 2009, CVS filed with the Commission a quarterly report on Form 10-Q for its third quarter ended September 30, 2009 containing unaudited financial statements that included adjustments to the Longs PPA. Compared to the valuation firm's January 2009 draft report, the value of Longs tangible assets was reduced by \$212 million and goodwill was increased by the same amount. The reduction of tangible assets resulted primarily from a \$189 million decrease in the value of the Longs stores' personal property (from \$229 million to \$40 million). Despite the "continued use" premise that had been built into the valuation firm's January 2009 draft report, CVS now completely wrote off all personal property in approximately 430 of the 525 Longs stores, including more than 360 stores that were going to be operated for the long term.

4. In its third-quarter 2009 unaudited financial statements, CVS made a one-time catch-up adjustment reversing \$49 million of the depreciation that had been taken on Longs personal property from October 20, 2008 through June 30, 2009, and it did not take an additional \$19 million of depreciation that would otherwise have been taken on Longs personal property in the third quarter. The one-time depreciation reversal increased CVS's third-quarter 2009 earnings per share ("EPS") by approximately 2.4¢.²

5. The Longs PPA adjustments did not comply with generally accepted accounting principles ("GAAP"), specifically SFAS 141, because: (1) they did not reflect the expected future use of the Longs personal property as of the acquisition date in October 2008; (2) they did not

¹ SFAS 141 was superseded by SFAS 141R as of December 2008 – two months after the Longs acquisition.

² CVS emphasizes, and analysts usually focus on, the company's "adjusted" EPS – GAAP EPS minus amortization and net of tax. All references to EPS in this Order are to adjusted EPS.

reflect information that CVS knew or had arranged to obtain as of the acquisition date; and (3) they did not account for CVS's use of the assets to generate revenue after the acquisition date. The failure to comply with GAAP had a material impact on the company's third-quarter 2009 financial results.

6. Between the time that CVS initially included the Longs PPA in its 2008 financial statements and the time it adjusted the Longs PPA in its financial statements for the 2009 third quarter, Daniels took a series of steps to improperly alter the Longs PPA in order to get a more positive accounting impact for CVS.

7. On June 16, 2009, Daniels told a co-worker that he had been making "some good progress on the tangible asset side" with the valuation firm and that he was now "extremely confident (by the way that's the most confident I get) that the final valuation will no longer be a bad guy but rather a good guy." (Daniels routinely used the terms "good guy" and "bad guy" to indicate whether an item improved or harmed CVS's purported profitability.)

The Original Purchase Price Allocation for the Longs Acquisition

8. In November 2008, CVS hired a major accounting firm to prepare a valuation for the Longs PPA. The engagement letter specified that, applying SFAS 141, the firm would determine the "fair value" of the Longs assets "as part of a 'going concern in continued use,'" and that "this valuation premise presupposes the continued utilization of the assets in connection with all other assets as the highest and best use." The engagement letter called for the firm to submit "Phase One" summary schedules by December 31, 2008 and a draft "Phase Two" report three weeks later.

9. On November 4, the valuation firm asked CVS for certain information about the Longs tangible assets, including "Information regarding any future use / development / refurbishment projects at existing stores. List of rationalization / store closure plans."

10. On December 14, Daniels (who was then the Director of Budgeting and Forecasting) told the CVS real estate group to provide the valuation firm with the latest strategy for using the Longs drugstores, adding "I know it's not final but I assume it's pretty close."

11. On December 15, the Real Estate Finance Director provided the valuation firm with the current strategy for each Longs store, along with a cover email from a manager in the real estate group stating, "I don't expect many changes." The list indicated that CVS planned to close 36 stores right away, relocate 19 stores within one year, operate 123 stores with the intent to relocate them within three years (if possible), and operate 349 stores for the long-term. Soon after, the Finance Director told another manager in the real estate group that the December 15 list was "predominately finished, but will have limited ongoing changes."

12. The valuation firm's approach to determining the "fair value" of the tangible assets in the Longs stores depended on CVS's intended use of each store.

a. For assets in the stores to be operated for more than one year, the firm applied a "continued use" premise. The firm determined the "direct replacement cost" for the leasehold improvements and the furniture, fixtures and equipment ("FF&E") in each store, using

data from the CVS real estate group that a typical new CVS store had fixed costs of \$45,101 and variable costs of \$38.77 per square foot. The firm applied an "indirect cost approach" (historical cost trended forward) for the computer equipment and the assets in the Longs corporate locations.

b. For the assets in the stores to be closed within one year, the firm determined the "orderly liquidation value" using data from the CVS real estate group indicating that approximately 35% of the assets would have liquidation value.

13. On December 23, the valuation firm sent draft schedules to the Retail Controller (Daniels' predecessor in this position). For the Longs drugstores, the real property was valued at \$937.2 million and the personal property was valued at \$229.3 million. These schedules were the "Phase One" summary schedules required by the engagement letter. The Retail Controller forwarded the schedules to CVS's outside auditors.

14. On January 12, 2009, the Retail Controller asked the valuation firm for "updated valuation schedules that reflect all changes to date." He also stated, "We are entering the danger zone on closing the year. If there are any significant open items affecting the current valuation estimates, we have to resolve them tomorrow." Minutes later, a Senior Manager at the valuation firm replied that, on a recent call with CVS's outside auditors, "all of the major issues were discussed and agreed to, which would mean leaving our analysis as is."

15. On January 13, the valuation firm sent updated schedules to the Retail Controller. For the Longs retail operations, the valuation of real property (\$937.2 million) and personal property (\$229.3 million) was unchanged from the schedules sent on December 23. The Retail Controller forwarded the schedules to the Controller and to CVS's outside auditors.

16. Also on January 13, CVS's outside auditors told the Retail Controller that they wanted to have "a quick wrap up call this morning on the Longs valuation just to make sure we are all on the same page and close down our procedures. We wanted to talk about the wrap up process [and] timing of [the] narrative from [the valuation firm] etc."

17. As of mid-January, the valuation firm was not performing any additional valuation work, and both the Retail Controller and CVS's outside auditors expected that the firm would submit its report in time for inclusion in the 2008 audit.

18. On January 27, the valuation firm submitted a draft report that applied the "continued use" valuation premise mandated in the engagement letter (except for the stores to be closed). The valuation of the Longs drugstores had not changed from the draft schedules sent on December 23 and January 13: \$937.2 million of real property and \$229.3 million of personal property. The draft report was the "Phase Two" narrative report required by the engagement letter.

19. Between November 2008 and January 27, 2009, CVS and its outside auditors were in regular communication with the valuation firm about its work. At no point did CVS or the outside auditors express any concerns about the valuation firm's approach to the valuation. Nor did CVS tell the valuation firm about any plans to dispose of almost all personal property in most Longs stores, despite the firm's specific request for information about "future use / development / refurbishment projects at existing stores." As a result, the valuation firm assumed that the conversion of Longs stores to CVS stores would primarily entail a change of signage.

20. After submitting its draft report on January 29, the valuation firm waited for comments from CVS's outside auditors so it could prepare its final report. On January 30, the Retail Controller told the firm: "[The auditors] completed their review of the draft valuation report and had no comments. Please issue your report in final form as soon as you can." The firm responded that it would send a draft management representation letter for CVS to sign, as well as "a final invoice for our work."

21. On January 31, the Retail Controller told the valuation firm to put finalizing the valuation report "on hold" in light of an upcoming meeting between the firm and the CVS real estate group.

22. On February 2, a manager in the CVS real estate group sent the valuation firm a list of topics to be discussed on a call later that day. Most of the topics concerned the accounting for leasehold interests and personal property in Longs stores to be closed. None of the topics concerned the remodeling of any Longs stores.

23. On February 11, the valuation firm sent CVS a "final summary" of the Longs valuation. The personal property in the Longs drugstores was still valued at \$229.3 million.

24. In connection with the year-end 2008 audit, CVS's outside auditors reviewed the valuation firm's approach to valuing tangible assets and concluded that the firm's methodology was reasonable. While the outside auditors were working on the 2008 audit, CVS did not disclose anything about its plans to remodel any Longs stores, and so the auditors did not review the Longs valuation report for any potential impact of the remodeling.

25. CVS included the values from the January 29 draft valuation report in its audited financial statements for 2008, which were included in its annual report to shareholders for 2008 and were incorporated by reference in the annual report on Form 10-K that it filed with the Commission on February 27. Note 2 to the audited financial statements, entitled "Business Combinations," indicated that CVS had acquired Longs for approximately \$2.6 billion. Note 3, entitled "Goodwill and Other Intangibles," stated that "goodwill increased primarily due to the Longs Acquisition" and that the increase in amortizable intangible assets "was primarily due to the preliminary purchase price allocations (which may change and the result of such changes, if any, may be material)." The audited financial statements did not contain any indication that the valuation of Longs tangible assets such as personal property was not final.

26. The asset values from the January 29 draft valuation report were loaded into CVS's books and records, and CVS began taking depreciation on the Longs assets.

27. On February 27, the Real Estate Finance Director asked the valuation firm about potential adjustments to the value of assets in the Longs stores to be closed. He also wrote:

Plus, it seems there have been several changes in individual store strategies over the past few weeks, and I would guess these have not been picked up by you guys or [the Retail Controller]. I would like to talk about how these changes and future changes should be handled with respect to these value adjustments.

Minutes later, a Senior Manager at the valuation firm responded with a warning:

[K]eep in mind that any changes in strategy that were not known as of the acquisition date cannot be reflected in the valuation. The valuation was as of October 30, 2008. So the valuation can only reflect the strategies in place at that time – which I believe we accurately reflected. Any changes after the valuation date would have to be discussed with your audit team.

28. The valuation firm did not perform any further work on the Longs valuation between February and April, although it responded to occasional questions from CVS.

**Daniels Persuaded the Valuation Firm to Reduce its
Valuation of the Longs Stores' Personal Property by \$189 Million**

29. In March 2009, the CVS fixed asset group adjusted the depreciation being taken on Longs FF&E and technology assets by lengthening the remaining useful lives beyond the time period that the valuation firm had used. In other words, the fixed asset group assumed that these assets in the Longs stores would remain in use for a longer period than the valuation firm had assumed.

30. In April, the CVS property accounting group identified a discrepancy between the depreciation on Longs assets built into the 2009 budget and the actual depreciation being taken on those assets. On April 30, the Controller complained to the Retail Controller and to Daniels, who was then Vice President for Corporate Budgeting, that the CVS fixed asset group had apparently made decisions about the remaining useful lives of Longs assets that were inconsistent with the valuation firm's draft report, and the result was an unfavorable variance of \$20 million per month.

31. In early May, the Controller fired the Retail Controller. Daniels became the Retail Controller and took charge of working with the valuation firm on the Longs valuation. (At the time, the Controller was being scrutinized by CVS senior management as a possible successor to the CFO, who had expressed his intent to retire.)

32. On May 1, the Controller and Daniels asked for a conference call with the valuation firm on May 8. On May 7, Daniels prepared a list of four topics for the call: (1) a request for a summary schedule listing each asset class and the remaining useful lives; (2) a discussion of any recent changes in the valuation; (3) a discussion of the fair value and remaining useful lives for the "technology" assets; and (4) an apparent discrepancy in the labeling in two versions of the valuation schedules. The list did not mention the remodeling of any Longs stores or the disposal of any Longs assets. The Controller forwarded the list to the valuation firm.

33. As of May 8, the Controller had no concerns about the valuation of Longs drugstore assets or the projected depreciation on those assets.

34. After the call on May 8, the valuation firm sent Daniels its latest fixed asset valuation figures and the depreciation and amortization schedules that it had used. There had been no change to the \$229.3 million valuation of personal property in the Longs retail operations.

35. On May 11, after reviewing the materials he received from the valuation firm on May 8, Daniels told the Controller that: (1) the blame for the depreciation variance lay with the fixed asset group; (2) the valuation firm's estimated fair values and suggested remaining useful lives were the same as used by CVS in its current budget; and (3) the depreciation variance problem would likely be resolved in the financial results for April 2009.

36. At no point between January 27 and May 13 did CVS tell the valuation firm about any plans to dispose of almost all of the Longs stores' personal property, despite the firm's specific request for such information back in November 2008.

37. On May 13, Daniels told the valuation firm during a conference call that:

a. CVS was remodeling the Longs stores that were going to be operated for the long-term, and as part of the remodeling process, CVS was gutting the stores and discarding all the personal property; and

b. CVS was not receiving any value for the assets being discarded.

Daniels also told the valuation firm that, as of the acquisition date on October 20, 2008, CVS had intended to throw out all that personal property in the Longs stores.

38. On May 19, a Senior Manager at the valuation firm warned Daniels that it appeared CVS was improperly changing its real estate strategy after the acquisition date:

I had the opportunity to discuss our call from last week with [name omitted]. [He] is the partner in charge of the tangible asset valuation practice in the US and was the tangible asset partner on the CVS engagement. We discussed many of the changes in the plans for the PP&E [property, plant and equipment] that have occurred since the acquisition. [The valuation firm] valued the PP&E as of the acquisition date utilizing the plans of CVS at this time. The valuation of the PP&E cannot be modified for changes in plans that occurred after the valuation date. The future plans of the company had to be known prior to the acquisition date. Any changes that have occurred over the last 7 months that were not known as of October 30, 2008 cannot be incorporated into the valuation.

One hour later, Daniels sent an email to allay the valuation firm's concerns:

As a reminder, what we would like to discuss is the assumptions used regarding the intended use of the assets to ensure that the correct plans were used. Rest assured we are not looking to change the plans regarding the use of the acquired assets as the plans remain unchanged since the close. Rather, we want to make sure the correct assumptions were used.

39. Also on May 19, the partner responsible for the valuation firm's overall relationship with CVS reported on a call with Daniels:

He said he understands the acctg [accounting] literature and believes that we were given incorrect info. He said they hadn't really looked at our final report until after March when the info that was loaded into their g/l [general ledger] didn't look right.

40. On May 20, Daniels told a co-worker that he was working with the valuation firm "to ensure their valuation assumptions are correct."

41. On May 26, Daniels had a conference call with the valuation firm. Prior to the call, Daniels provided the firm with CVS's current real estate strategy for the Longs stores. The strategy list indicated that CVS planned to: (1) close 71 stores within one year; (2) operate 124 stores with the intent to relocate them within three years (if possible); and (3) operate 333 stores for the long-term. Daniels also sent the firm an overview of the store remodeling project. The remodel overview indicated that 420 stores would be remodeled to some extent, of which 361 stores would receive a "full remodel." (The stores not being remodeled at all were stores that had been or were about to be closed, as well as stores in Hawaii that were going to retain the "Longs" name.). The remodel overview indicated that less than one-third of the "full remodel" stores were going to receive all-new fixtures. However, Daniels told the valuation firm that all assets in all 361 "full remodel" stores were being scrapped.

42. The valuation firm's internal manual on SFAS 141 stated that PPA adjustments are appropriate only if "the necessary information was determinable at the time the preliminary allocation was reported," as when, for example, the acquiring entity has commissioned an appraisal of plant and equipment that is not complete by the acquisition date.

43. The valuation firm accepted Daniels' statements in May that, as of the acquisition in October 2008, CVS intended to throw out personal property in the stores to receive a "full remodel," and that CVS's failure to provide the firm with the correct information for six months after the firm was retained was due to a "miscommunication." If the valuation firm had received this information before it submitted its draft report in January 2009, the fair value of the Longs drugstore assets would have been significantly reduced.

44. On June 3, the valuation firm told Daniels that the personal property in the Longs drugstores was now valued at \$49.6 million (compared with \$229.3 million as of May 8). The firm reduced the value of personal property by \$179.7 million based on the supposedly correct information provided by Daniels in May – that, as of the acquisition date on October 20, 2008, CVS intended to discard the assets in the stores to be remodeled, and that the discarded assets had no liquidation value.

45. On June 4, Daniels received a copy of the outside auditors' internal manual on SFAS 141R.³ The manual stated:

The measurement period ends once the acquirer is able to determine that it has obtained all necessary information that existed as of the

³ SFAS 141R expanded the subjects that can be modified during the allocation period but did not change the definition of the allocation period itself.

acquisition date or has determined that such information is unavailable...

Once the acquirer obtains the information it has arranged to obtain or determines that the information does not exist, then the measurement period is closed. The measurement period is not a fixed twelve-month period during which all changes in carrying values of assets acquired or liabilities assumed are considered adjustments to the business combination accounting.

46. On June 16, Daniels told a co-worker, "Wanted to give you a quick update on the Longs valuation. We have made some good progress on the tangible asset side based on having [the valuation firm] update their assumptions to include the correct real estate disposition and intended use of the assets."

47. On July 28, the valuation firm sent Daniels an "updated draft" of its valuation report. The text of the report had not changed since the January 27 draft, but the value of personal property in the Longs drugstores had been reduced from \$229.3 million to \$50.8 million.

48. On October 1, the valuation firm sent Daniels a "final draft" of its valuation report. The text of the report had not changed since the draft sent on July 28. However, the value of personal property in the Longs drugstores had been further reduced – from \$50.8 million to \$39.6 million. The total reduction in the value of personal property in the Longs drugstores since the firm's January 27 draft report was approximately \$189 million (from \$229.3 million to \$39.6 million).

CVS's Outside Auditors Accepted the \$189 Million Reduction in the Valuation of the Longs Stores' Personal Property

49. Until the spring of 2009, CVS's outside auditors were not aware that CVS planned to discard almost all of the Longs stores' personal property.

50. In early June 2009, Daniels told the outside auditors that CVS had finalized its strategy for which Longs stores would be closed, relocated or remodeled, and that the adjustments to the valuation of the Longs stores could be larger than expected, because CVS was going to scrap all personal property in the stores being remodeled. That was the first time the outside auditors heard about the write-off of assets in stores being remodeled. The Coordinating Partner told the Engagement Partner that he was a "little worried about what he [Daniels] may be trying to do."

51. On June 19, Daniels told a member of the Longs remodeling team at CVS:

I'm close to completing the valuation work with [the valuation firm] for Longs. One final step I have is getting our auditors comfortable with the changes. Our auditors were hoping they could see a summary of what we are spending on the resets [remodels] that have been completed. Is it possible to get a summary (with some detail) for the 4 stores that are done? Since we are writing off a lot of the assets they

would feel more comfortable seeing that we're spending a fair amount per store to reset them.

52. On September 25, the Manager of Property Accounting provided Daniels with a spreadsheet listing the amount spent on remodeling: (1) each Longs location whose assets had been written down to zero, and (2) each Longs location whose assets were included in the residual valuation of \$50 million:

You had asked me to compare the Long's Personal Property acquisition assets that retained their value (\$50M) following the recent revaluation, to the total spending for the Long's Reset capital projects. This analysis is attached.

As you can see on the "Summary" tab, the theory you outlined to me holds true for the majority of the stores. Those stores that have retained-value acquisition assets generally have lower levels of spending on their Reset projects. Conversely, those locations that have significant Reset spending generally do not have large acquisition asset activity. There are exceptions, of course, but in general the attached information supports your position.

53. The language in these emails is very revealing. Daniels asked for data about "reset spending" at the Longs stores to help the outside auditors get "comfortable" because CVS was "writing off a lot of the assets." He did not ask for confirmation that CVS was actually scrapping all personal property in the stores being remodeled. The Manager of Property Accounting told Daniels that, "for the majority of the stores," the data supported "the theory you outlined to me" and that "in general the attached information supports your position." The "theory" and "position" which Daniels had outlined to him was simply that stores with lower retained asset values tended to have more "reset spending" – not that all assets in the "full remodel" stores were actually being discarded.

54. On October 5, the outside auditors' Senior Manager alerted others members of the audit team about the upcoming finalization of the Longs PPA:

The biggest change is that PP&E went from 229 million in the initial valuation to 50 million (and in final one expected to be 39 million).

The reason behind this as it has been explained to us is that CVS was either resetting / relocating / closing a number of the stores that was never communicated to [the valuation firm] and therefore an asset value was assigned that was way too high.

55. On October 8, after the valuation firm had further reduced the valuation of the remaining Longs store assets to \$39 million, the Manager of Property Accounting sent Daniels an updated store-by-store spreadsheet reflecting a total of \$97 million of "reset [remodeling] project" spending and \$225 million of "post-acquisition" spending. Daniels forwarded the spreadsheet to the outside auditors.

56. On October 14, the valuation firm's Senior Manager provided Daniels with answers to questions from the outside auditors about the revised valuation. In response to the auditors' request for clarification about the adjustments to personal property, the Senior Manager wrote:

We were provided an updated strategy list from CVS that contained a future plan for each store. Below is a synopsis of how we valued the personal property for each strategy.

Remodel – We were informed that stores that were being remodeled from a Long's to a CVS were being gutted and the personal property was being scrapped. CVS was not obtaining any residual value for these assets as they were being discarded. Therefore the personal property at stores that were undergoing a complete renovation to a CVS were given no value (scrap = \$0).

Closed Stores – All stores that were closed were being gutted and none of the personal property was being retained by CVS. The personal property was valued at \$0.

Closing Stores – Stores that would be operated for less than 1 year and then closed – We valued the personal property with a 1 year RUL [remaining useful life]. The depreciation was accelerated so that the personal property would be fully depreciated at the end of 1 year.

Stores that were being converted to CVS for long term use and underwent minor cosmetic changes – We valued the personal property in continued use and the signage at \$0.

Daniels forwarded the valuation firm's response to the outside auditors.

57. Daniels never provided the outside auditors with any documents specifically confirming that CVS was gutting all the "full remodel" stores. Instead, when they accepted the PPA adjustments, the outside auditors relied on: (1) the representations by Daniels that CVS had always intended to scrap all assets in the Longs stores to be remodeled; and (2) the data identifying the amount of capital expenditures at each store.

CVS's Form 10-Q for the Third Quarter of 2009 Included Adjustments to the Longs PPA

58. On November 5, CVS filed a Form 10-Q with unaudited financial statements for the third quarter of 2009 that included adjustments to the Longs PPA.

59. Compared to the valuation firm's January 2009 draft report, the value of Longs tangible assets was reduced by \$212 million and goodwill was increased by the same amount. The reduction of tangible assets resulted primarily from the \$189 million decrease in the value of personal property in the Longs drugstores reflected in the firm's "final draft" valuation report dated October 1.

60. CVS made a one-time catch-up adjustment by reversing \$49 million of the depreciation taken on Longs assets from the closing in October 2008 through June 2009. In addition, CVS did not take \$19 million of depreciation that would otherwise have been taken on Longs assets in the third quarter.

61. The \$49 million one-time depreciation reversal increased third-quarter 2009 EPS by 2.4¢.

Daniels Caused CVS to Make Improper Accounting Adjustments

62. Daniels told a co-worker on June 16, 2009 that he had been making “some good progress on the tangible asset side” with the valuation firm and that he was now “extremely confident (by the way that’s the most confident I get) that the final valuation will no longer be a bad guy but rather a good guy.”

63. Some of Daniels’ statements to the valuation firm and the outside auditors are inconsistent:

a. Daniels told the valuation firm on May 19 that no one at CVS had really looked at the January 27, 2009 draft report until after March, and that CVS became worried about the valuation only when the values that were loaded into its general ledger “didn’t look right.” However, Daniels told the Controller earlier in May that the valuation firm’s estimates of fair value and suggested remaining useful lives were the same as used by CVS in its current budget.

b. Daniels told the valuation firm and the outside auditors on several occasions that CVS had not provided the valuation firm with the correct plans for the Longs stores. However, on September 28, Daniels told the Controller that the PPA adjustments should not be considered as the correction of an error:

[W]e don’t fall under this scenario in my opinion as the r/e [real estate] strategy was still being worked on, thus we didn’t ignore available info resulting in an error. Rather we were waiting to gather info to complete the valuation in the first place.

64. More importantly, the facts fatally undermine Daniels’ justification for the PPA adjustments—that, as of the acquisition date on October 20, 2008, CVS intended to scrap all assets in the Longs stores to be remodeled.

65. When CVS acquires a chain of drugstores, it typically tries to reuse as many assets as possible, and it makes a store-by-store determination about the ultimate disposition of the assets. When it acquired the Longs stores in October 2008, CVS did not know what its remodeling plan was going to be or which assets in the stores to be retained would have value. As a result, it took months after the acquisition for CVS to develop its plans for remodeling the Longs stores.

66. On October 17, 2008, the CVS real estate group circulated a “Longs Integration Update” indicating that CVS would “update the look of the Longs’ fleet of stores” with “CVS Decor Elements – Graphics, Aisle Guides, Carpet, Paint etc.” The document contained numerous

references to the minimization of construction costs, the retention of many existing fixtures, and the need to finalize the scope of work.

67. On January 6, 2009, a member of the CVS real estate group circulated a brief comparison between the company's plans for the Longs stores and its treatment of the Albertsons stores that CVS had acquired a few years earlier:

LDG [Longs]: Retain major elements from Longs > Total Visual Appeal (TVA) Remodel store program.

ABS [Albertsons]: All new CVS design.

Benefit: Reduced cost while adding CVS look and feel elements (e.g. aisle markers, graphics, carpet etc).

68. On January 29, members of the Longs integration team reported on a site visit to a model "Alpha" store that had been built in an empty location to assess possible interior design elements for the remodeled Longs stores. The report included several suggestions for how to adapt to the taller shelving in a Longs store and how to respond to customer feedback.

69. On February 13, members of the Longs integration team submitted a report on the "Alpha" store that included "reusing existing fixtures where possible, even if not standard for CVS."

70. On February 19, the CVS real estate group circulated a proposed budget of \$202 million for the Longs store remodeling project. For the 419 stores to be remodeled, the report identified five levels of work, running from the "A+ scope" costing \$640,000 per store to the "C scope" costing \$67,000 per store. Another presentation of the proposed budget noted that "the following areas drive the costs: 1) photo/checkout; 2) former cosmetic service areas; 3) carpets." There was no reference to the complete replacement of all fixtures in all remodeled stores.

71. On May 1, members of the Longs integration team reported on lessons learned from the five "Beta" stores built in March. The report mentioned potential changes to the store design and concluded, "Save tens or hundreds of thousands of dollars by keeping some existing elements."

72. On May 22, the CVS real estate group circulated a "Longs Remodel Overview" indicating that 420 stores were being remodeled to some extent. 361 stores would receive a "full remodel" that included:

New CVS checkout: this will require the removal of 1 or 2 grocery style checkout lanes;

New CVS Photo Lab: this will require the removal of the existing Longs photo lab in order to accommodate the CVS design;

New Graphics/Wayfinding: all existing Longs department and merchandise graphics will be replaced with the standard CVS package;

New exterior signage: replacement of existing Longs banner with CVS/pharmacy.

The overview indicated that, despite the nomenclature, only 111 of the 361 "full remodel" stores (fewer than one-third) were going to receive "replacement of existing wall and gondola fixtures."

73. Although it did not involve the gutting of all stores to be operated for the long-term, the final remodeling plan was more extensive than either CVS or its outside auditors had initially expected.

The Longs PPA Adjustments Did Not Comply with GAAP

74. Under SFAS 141 ("Business Combinations"), an acquiring entity should allocate the cost of the acquired entity to the assets and liabilities assumed "based on their estimated fair values at [the] date of acquisition." [¶35.] "Plant and equipment" should be valued at "current replacement cost ... unless the expected future use of the assets indicates a lower value." [¶37d(1).]

75. Under SFAS 141, an "allocation period" may be needed "to identify and measure the fair value" of the assets and liabilities. [Appendix F.] The allocation period "is intended to differentiate between amounts that are determined as a result of the identification and valuation process ... and amounts that are determined because information that was not previously obtainable becomes obtainable." [¶B183.] The allocation period "ends when the acquiring entity is no longer waiting for information that it has arranged to obtain and that is known to be available or obtainable." [Appendix F.] In other words, a PPA adjustment is valid only if it is based on information that the acquiring entity "has arranged to obtain" and that was "known to be available or obtainable" on the acquisition date.⁴

76. Under SFAS 141, CVS could only make adjustments to the Longs PPA based on information that was known or knowable as of the acquisition date on October 20, 2008. Given the facts set forth above, the PPA adjustments in the third quarter of 2009 (writing off \$189 million of personal property in the Longs stores) were not proper under SFAS 141 because:

- a. They did not reflect CVS's intended future use of those assets as of the acquisition date on October 20, 2008;
- b. They did not reflect information that was known or knowable to CVS as of October 20, 2008; and
- c. They did not account for CVS's use of the assets to generate revenue after October 20, 2008.

77. The conclusion that the write-off of assets supposedly discarded during the remodeling process should not have been treated as a PPA adjustment is consistent with CVS's

⁴ See also Staff Accounting Bulletin No. 103 ("The staff believes that the allocation period should not extend beyond the minimum reasonable period necessary to gather the information that the registrant has arranged to obtain for purposes of the estimate.").

prior acquisitions, in which: (1) CVS did not write off the assets in stores being remodeled; and (2) subsequent decisions about which stores to close (not which stores to remodel) were the primary reason for changes to the PPA.

78. Under SFAS 144 ("Accounting for the Impairment or Disposal of Long-Lived Assets"),⁵ if CVS really had discarded \$189 million of personal property in the third quarter of 2009, it should have:

a. Written off \$140 million of net book value (the original \$189 million minus the \$49 million of depreciation to date) as an expense in the period in which it stopped using the assets; and

b. Left the \$49 million of previously recorded depreciation unchanged.

79. With proper accounting, current-period expenses in the third quarter of 2009 would have been as much as \$189 million higher than was actually reported. For the quarter, the failure to recognize as much as \$189 million of current-period expenses overstated operating profit by as much as 13.7%, overstated income from continuing operations by as much as 12.5%, overstated net income by as much as 12.5%, and overstated EPS by as much as 17% (as much as 9.3¢).

Violations

80. As a result of the conduct described above, Daniels:

a. Violated Section 17(a)(2) and (3) of the Securities Act, which prohibits making untrue or misleading statements of material fact or engaging in conduct which operates or would operate as a fraud or deceit upon the purchaser in the offer and sale of securities. Sections 17(a)(2) and 17(a)(3) do not require a showing of scienter. *Aaron v. SEC*, 446 U.S. 680, 697 (1980);

b. Violated Rule 13b2-1 promulgated under the Exchange Act, which prohibits any person from directly or indirectly falsifying any books and records subject to Section 13(b)(2)(A) of the Exchange Act;

c. Aided and abetted and caused CVS's violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder, which require an issuer to file accurate quarterly reports with the Commission and require those reports to contain such further material information as is necessary to make the required statements in the reports not misleading;

d. Aided and abetted and caused CVS's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, which require an issuer to make and keep books and records that accurately and fairly reflect the dispositions of its assets, and to devise and maintain a system of internal accounting controls sufficient to ensure that its transactions comport with Generally Accepted Accounting Principles; and

⁵ FASB statements were codified for all interim periods ending after September 15, 2009. SFAS 144 has been codified as ASC 360, *Property, Plant and Equipment*.

e. Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, willfully violated Section 17(a)(2) and (3) of the Securities Act and Rule 13b2-1 promulgated under the Exchange Act, and also willfully aided and abetted and caused CVS's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.⁶

Findings

81. Based on the foregoing, the Commission finds that Daniels: (a) willfully violated Section 17(a)(2) and (3) of the Securities Act and Rule 13b2-1 promulgated under the Exchange Act; and (b) willfully aided and abetted and caused CVS's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Daniels' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Daniels shall cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-13, and 13b2-1 thereunder and Section 17(a) of the Securities Act.

B. Daniels is denied the privilege of appearing or practicing before the Commission as an accountant, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

C. After one year from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
2. an independent accountant.

Such an application must satisfy the Commission that: (a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting

⁶ As used in these findings, a willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective; (b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision; (c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and (d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent shall, within 10 days of the entry of this Order, pay a civil penalty in the amount of \$75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways: (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Laird Daniels as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to John T. Dugan, Associate Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Boston, MA 02110.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Aguilar
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9574 / April 8, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71903 / April 8, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3812 / April 8, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31012 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15826

In the Matter of

KEIKO KAWAMURA,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTION
21C OF THE SECURITIES
EXCHANGE ACT OF 1934,
SECTIONS 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF
1940, AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF
1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Keiko Kawamura ("Respondent" or "Kawamura").

II.

After an investigation, the Division of Enforcement alleges that:

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A. SUMMARY

1. This proceeding involves schemes to defraud and fraudulent misrepresentations and omissions by Keiko Kawamura in connection with money she raised for a self-described hedge fund that she purportedly managed, and money she obtained from subscribers to a website she operated to provide investment advice.

2. From December 2011 through June 2012, Kawamura raised approximately \$200,000 from at least seven investors for a hedge fund that she purportedly managed. Kawamura falsely told investors, among other things, that she had substantial experience in the financial industry (including in the trading of stocks and options), and that she had achieved outstanding returns trading stocks and options in her own accounts. Despite her promises to invest the funds she obtained, Kawamura misappropriated much of the money. Of the funds she did invest, Kawamura lost everything in risky options trading.

3. In August 2012, Kawamura started a website – kawamurafinancial.com – where she provided investment advice for a monthly subscription fee until February 2014. Kawamura solicited subscribers through a number of misrepresentations, including falsely claiming that she obtained an annual return in excess of 800% in her personal brokerage account (in fact, she lost all of the money invested in the account), that she had managed millions of dollars, and that she had nearly ten years of experience in the financial industry. Kawamura made approximately \$50,000 in subscription fees from approximately 70 different subscribers to her website.

B. RESPONDENT

4. **Keiko Kawamura** (d/b/a Kawamura Financial), 27 years old, is a resident of Honolulu, Hawaii. From December 2011 through June 2012, Kawamura acted as an investment adviser to a self-described hedge fund in which she pooled and managed monies she raised from at least seven investors for a purported performance fee of 20% of any profits achieved. In August 2012, Kawamura established a website that she operated until February 2014 and on which she provided investment advice to subscribers for a monthly fee.

C. FACTUAL BACKGROUND

5. Beginning in December 2011 and continuing through the present, Kawamura (d/b/a Kawamura Financial) engaged in two separate fraudulent schemes in connection with the purchase and sale of securities, made material misrepresentations and omissions in connection with money she raised directly from investors, and made material misrepresentations and omissions in connection with a website she operated to provide investment advice.

6. From December 2011 through June 2012, Kawamura offered and sold interests in a self-described hedge fund. Kawamura told investors that she would pool their funds in a single brokerage account in which Kawamura would invest in stocks and options. Kawamura told investors that she would be compensated by receiving 20% of any profits achieved in the account. In total, Kawamura raised approximately \$200,000 from at least seven investors.

7. In soliciting investors for her "hedge fund," Kawamura told investors that she had extensive experience trading stocks and options and was managing millions of dollars in what she referred to as a hedge fund. In fact, as Kawamura knew, her only prior trading experience had been placing a small number of trades over the preceding few months in an account held in her boyfriend's name and less than \$10,000 traded in brokerage accounts held in her name. At no time did her boyfriend's account in which she made trades hold more than \$300,000 and at no time did accounts that she controlled and/or managed hold more than approximately \$55,000.

8. Contrary to Kawamura's representations to investors that she would invest all of the funds she raised in stocks and options, she misappropriated much of the hedge fund's money to pay for her living expenses and for luxury vacations to Miami and London. Of the approximately \$55,000 Kawamura did invest, she pooled the money in one brokerage account and lost it all in highly risky options trades.

9. Kawamura posted screenshots of portions of a brokerage account statement on her Twitter account, which many of her investors followed, that suggested that she was obtaining incredible returns in her own brokerage accounts. In fact, the screenshots reflected particular returns on unusually successful trades and/or trading days from her boyfriend's brokerage account and were not indicative of the performance of the trading in her account. At the time she posted the screenshots, Kawamura knew that her trading had not performed at the level indicated by the screenshots.

10. Kawamura's misrepresentations and omissions were material. The investors she solicited would not have invested in her hedge fund had Kawamura not misrepresented or otherwise failed to accurately disclose, among other things, her prior experience trading in the stock market and managing investor money, the true amount of money she was actually "managing," her prior trading performance, and/or the intended use of investor funds.

11. After raising money from investors through her misrepresentations and omissions, Kawamura engaged in further manipulative and deceptive acts as part of her scheme to defraud investors. Despite losing the money she invested, Kawamura repeatedly told investors that she was achieving excellent returns on their investments. Kawamura also created, and provided to certain investors, false tax documents that purported to show that she had invested all of the money she had raised when, in fact, she had misappropriated much of it. Despite losing the money she invested, Kawamura repeatedly assured investors seeking to withdraw their investments that she was

achieving excellent returns on their investments and that she just needed additional time before she could process any withdrawals.

12. In August 2012, Kawamura started a website called kawamurafinancial.com. Kawamura promoted her website primarily through social media, including Twitter and Facebook. Kawamura used the website to provide investment advice to members who paid a monthly fee of between \$94.95 and \$174.95. The subscription fee varied based on the level of access granted to Kawamura's website. All subscribers received access to, among other things, a locked Twitter account that Kawamura used to provide recommendations on when to sell or purchase particular stocks and options.

13. Kawamura's website contained numerous material misrepresentations and omissions that she acknowledges were intended to attract subscribers. Kawamura claimed on the site that she had "been in the Investment banking industry for nearly a decade, specializing in Wealth Management for a major Financial Institution." At the time she created her website, Kawamura knew this was false. She has never worked in the investment banking industry and has never worked for any financial institutions.

14. Kawamura also falsely claimed on her site that "Her Personal IRA account is up almost 800% YTD (2012)." In fact, as Kawamura knew at the time she created her website, she lost all of the money in her personal IRA brokerage account over a period of about two months in 2012.

15. Kawamura also provided all subscribers to her website with access to one-on-one advice over Skype's instant message service in which she would provide specific recommendations regarding stocks and options to the subscriber. Subscribers that paid \$174.95 a month were also provided access to Kawamura's trades in "real-time." Kawamura received nearly \$50,000 from approximately 70 subscribers to her website.

16. These misrepresentations and omissions were material. The subscribers to Kawamura's website would not have subscribed had Kawamura not misrepresented, among other things, her prior experience trading in the stock market and managing investor money, and/or her prior trading performance.

D. VIOLATIONS

17. As a result of the conduct described above, Kawamura willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

18. As a result of the conduct described above, Kawamura willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit fraudulent conduct by an investment adviser.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and (j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 9(d) and (e) of the Investment Company Act; and

D. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, and Section 203(i) of the Advisers Act, and whether Respondent should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, and Section 203 of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against her upon consideration of this Order, the allegations of which may be

deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71905 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15828

In the Matter of

Matthew J. Blevins

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 17A(c) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 17A(c) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Matthew J. Blevins ("Blevins" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 17A(c) and 21C of the

Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

Respondent

1. Matthew J. Blevins, age 38, resides in Las Vegas, Nevada. He is a vice president in charge of operations of Empire Stock Transfer, Inc., a transfer agent registered with the Commission. From 2002 until joining Empire in 2007, Blevins was associated with a broker-dealer registered with the Commission.

Other Relevant Parties

2. Empire Stock Transfer, Inc. ("Empire") is a Nevada corporation located in Henderson, Nevada, and has been registered as a transfer agent with the Commission since May 2004.

3. Patrick R. Mokros ("Mokros") is Empire's president. From 2003 until associating with Empire in 2004, Mokros was associated with a broker-dealer registered with the Commission.

4. Marcus A. Luna ("Luna") was an undisclosed control person of Empire. He is an attorney currently licensed in the state of California. In December 2010, the Commission filed an action against Luna for violations of the anti-fraud provisions of the federal securities laws (*SEC v. Luna*, Case No. 2:10-CV-02166 (D. Nev.) (L.R. No. 21779 (Dec. 15, 2010))).

Background

5. Empire is a transfer agent registered with the Commission. As of 2013, Empire had been engaged by approximately 327 corporate issuers to perform various shareholder administrative functions, including recording changes in ownership of the issuers' stock, maintaining the issuer's security holder records, canceling and issuing stock certificates, distributing dividends, resolving problems arising from lost, destroyed or stolen certificates, and mailing proxy ballots and tabulating proxy votes.

6. Empire, as a registered transfer agent was required by Section 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder: (1) to register with the Commission by

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

filing a true, correct, and complete Form TA-1 in accordance with the instructions therein (Rule 17Ac2-1(a)); and (2) to file an amended Form TA-1 within 60 days (Rule 17Ac2-1(c)) if any information in its Form TA-1 became inaccurate, misleading, or incomplete to correct the information. The Form TA-1 required Empire to disclose, among other information: (1) its officers, owners, and control persons; (2) any other person, directly or indirectly, through agreement or otherwise exercise or have the power to exercise control over its management or policies; and (3) any other person who wholly or partially finances its business, directly or indirectly, in any manner other than a public offering of securities under the Securities Act or by credit extended in the ordinary course of business by suppliers, banks, or others. Empire was also required by Section 17(a)(3) of the Exchange Act to make and keep any reports required by Section 17A of the Exchange Act and the rules thereunder, including Forms TA-1.

7. On or about May 30, 2006, Mokros signed a Share Purchase Agreement, under which Mokros agreed to purchase all of Empire's outstanding stock for \$300,000. Mokros, however, did not pay the \$300,000 purchase price for the Empire shares; rather, the \$300,000 was paid by Luna. On June 2, 2006, the stock certificate for Empire was issued to Mokros.

8. From May 30, 2006, through 2008, Luna was significantly involved in Empire's operations, including (1) hiring personnel; (2) strategic decisions regarding the business lines to pursue; (3) revising Empire's procedures manual and transfer agent service contract; and (4) renting Empire's new premises. During this period, Luna also received most of Empire's profits. From May 30, 2006, through 2008, Luna received \$535,000 from Empire, while Mokros received \$179,461 from Empire. In addition, on April 12, 2010, Empire loaned \$200,000 to a company controlled by Luna, which was to be repaid by September 14, 2010; Luna's company never repaid the loan, and Empire never took any action to collect on the loan.

9. In January 2007, Empire hired Blevins to run Empire's day-to-day operations, including overseeing Empire's finances. In 2009, Blevins was given the title of vice president.

10. Since Blevins was hired by Empire in January 2007, Empire has filed three Forms TA-1 or amendments with the Commission. Although Empire filed these Forms TA-1 under Mokros's electronic signature, Blevins reviewed them before the filing and filed them with the Commission. These Forms TA-1 stated that by Empire's filing the form, Empire represented that the information in the forms was "true, correct, and complete."

11. The Forms TA-1 and amendments thereto required Empire to disclose: (a) "each Chief Executive Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director, and persons with similar status or functions"; (b) any person who had the "power to direct or cause the direction of the management or policies of a company, whether through ownership of securities, by contract, or otherwise"; and (c) any person or entity who "wholly or partially finance[d] the business of [Empire], directly or indirectly, in any manner other than by a public offering of securities pursuant to the Securities Act of 1933 or by credit extended in the ordinary course of business by suppliers, banks and others."

12. In Empire's Forms TA-1 and amendments thereto, Empire never disclosed Luna's or Blevins' control position in Empire or Luna's financing of the purchase of Empire.

13. As a result of the conduct described above, Blevins willfully² aided and abetted and caused Empire's violations of Sections 17(a)(3) and 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 17A(c) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Blevins cease and desist from committing or causing any violations and any future violations of Sections 17(a)(3) and 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder.

B. Respondent Blevins is censured.

C. Respondent Blevins shall pay civil penalties of \$25,000 to the United States Treasury. Payment shall be made in the following installments: \$12,500 within 10 calendar days of the entry of this Order; and \$12,500 within 180 days of the entry of this Order. If timely payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Payments by check or money order must be accompanied by a cover letter identifying Blevins as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine Echavarria, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Suite 1100, Los Angeles, California 90036.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aquila
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71904 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15827

In the Matter of

Empire Stock Transfer, Inc.
and Patrick R. Mokros

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 17A(c) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 17A(c) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Empire Stock Transfer, Inc. ("Empire") and Patrick R. Mokros ("Mokros") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 17A(c) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds¹ that

Respondents

1. Empire Stock Transfer, Inc. ("Empire") is a Nevada corporation located in Henderson, Nevada, and has been registered as a transfer agent with the Commission since May 2004.

2. Patrick R. Mokros ("Mokros"), age 32, resides in Ohio. Mokros is Empire's president. Prior to associating with Empire, Mokros was associated with a broker-dealer registered with the Commission.

Other Relevant Party

3. Marcus A. Luna ("Luna") was an undisclosed control person of Empire. He is an attorney currently licensed in the state of California. In December 2010, the Commission filed an action against Luna for violations of the anti-fraud provisions of the federal securities laws (*SEC v. Luna*, Case No. 2:10-CV-02166 (D. Nev.) (L.R. No. 21779 (Dec. 15, 2010)).

Background

4. Empire is a transfer agent registered with the Commission. As of 2013, Empire had been engaged by approximately 327 corporate issuers to perform various shareholder administrative functions, including recording changes in ownership of the issuers' stock, maintaining the issuer's security holder records, canceling and issuing stock certificates, distributing dividends, resolving problems arising from lost, destroyed or stolen certificates, and mailing proxy ballots and tabulating proxy votes.

5. Empire, as a registered transfer agent was required by Section 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder: (1) to register with the Commission by filing a true, correct, and complete Form TA-1 in accordance with the instructions therein (Rule 17Ac2-1(a)); and (2) to file an amended Form TA-1 within 60 days (Rule 17Ac2-1(c)) if any information in its Form TA-1 became inaccurate, misleading, or incomplete to correct the information. The Form TA-1 required Empire to disclose, among other information: (1) its officers, owners, and control persons; (2) any other person, directly or indirectly, through agreement or otherwise exercise or have the power to exercise control over its management or policies; and (3) any other person who wholly or partially finances its business, directly or indirectly, in any manner other than a public offering of securities under the Securities Act or by credit extended in the ordinary course of business by suppliers, banks, or others. Empire was also

¹ The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

required by Section 17(a)(3) of the Exchange Act to make and keep any reports required by Section 17A of the Exchange Act and the rules thereunder, including Forms TA-1.

6. On or about May 30, 2006, Mokros signed a Share Purchase Agreement, under which Mokros agreed to purchase all of Empire's outstanding stock for \$300,000. Mokros, however, did not pay the \$300,000 purchase price for the Empire shares; rather, the \$300,000 was paid by Luna. On June 2, 2006, the stock certificate for Empire was issued to Mokros.

7. From May 30, 2006, through 2008, Luna was significantly involved in Empire's operations, including (1) hiring personnel; (2) making strategic decisions regarding the business lines to pursue; (3) revising Empire's procedures manual and transfer agent service contract; and (4) renting Empire's new premises. During this period, Luna also received most of Empire's profits. From May 30, 2006, through 2008, Luna received \$535,000 from Empire, while Mokros received \$179,461 from Empire. In addition, on April 12, 2010, Empire loaned \$200,000 to a company controlled by Luna, which was to be repaid by September 14, 2010; Luna's company never repaid the loan, and Empire never took any action to collect on the loan.

8. In January 2007, Empire hired Matthew J. Blevins ("Blevins") to run Empire's day-to-day operations, including overseeing Empire's finances. In 2009, Blevins was given the title of vice president.

9. Since May 30, 2006, Empire has filed five Forms TA-1 or amendments with the Commission. Empire filed these Forms TA-1 under Mokros's physical signature (prior to January 11, 2007) or electronic signature (after January 11, 2007). These Forms TA-1 stated that by Empire's filing the form and Mokros's signing the form, they represented that the information in the forms was "true, correct, and complete."

10. The Forms TA-1 and amendments thereto required Empire to disclose: (a) "each Chief Executive Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director, and persons with similar status or functions"; (b) any person who had the "power to direct or cause the direction of the management or policies of a company, whether through ownership of securities, by contract, or otherwise"; and (c) any person or entity who "wholly or partially finance[d] the business of [Empire], directly or indirectly, in any manner other than by a public offering of securities pursuant to the Securities Act of 1933 or by credit extended in the ordinary course of business by suppliers, banks and others."

11. In Empire's Forms TA-1 and amendments thereto, Empire and Mokros never disclosed Luna's or Blevins' control position in Empire or Luna's financing of the purchase of Empire.

12. As a result of the conduct described above, Empire willfully² violated, and Mokros willfully aided and abetted and caused Empire's violations of, Sections 17(a)(3) and 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder.

Undertakings

Empire undertakes to:

13. Retain within 30 days after entry of this Order, the services of an Independent Consultant, not unacceptable to the Commission's staff, and thereafter exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. Empire shall retain the Independent Consultant to conduct a comprehensive review of, and recommend corrective measures concerning, its policies and procedures relating to the making, keeping, and filing of Forms TA-1 and Forms TA-2 with the Commission. Empire shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to Empire's files, books, records, and personnel as reasonably requested.

14. No more than 120 days after the entry of this Order, submit to the Commission's staff a written report that Empire will obtain from the Independent Consultant regarding Empire's policies and procedures. The report will include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for changes or improvements to the policies and procedures, and a procedure for implementing any recommended changes.

15. Adopt all recommendations made by the Independent Consultant, provided, however, that within 150 days after the entry of this Order, Empire will advise the Independent Consultant and the staff of the Commission in writing of any recommendations it considers unnecessary or inappropriate, Empire need not adopt that recommendation at that time, but instead propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation with respect to Empire's policies and procedures on which Empire and the Independent Consultant do not agree, Empire will attempt in good faith to reach an agreement with the Independent Consultant within 180 days of the entry of this Order. In the event that Empire and the Independent Consultant are unable to agree on an alternative proposal, Empire will abide by the determinations of the Independent Consultant.

16. To ensure the independence of the Independent Consultant, Empire: (a) shall not have authority to terminate the Independent Consultant, without the prior written approval of the Commission's staff; (b) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; (c) shall not be in and shall not have an attorney-client relationship with the Independent Consultant, and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports, or documents to the Commission or the Commission's staff.

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408,414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

17. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Empire or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Los Angeles Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Empire or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

18. Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Empire agrees to provide such evidence. The certification and supporting material shall be submitted to Diana Tani, Assistant Regional Director, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than 60 days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Sections 17A(c) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent Empire cease and desist from committing or causing any violations and any future violations of Sections 17(a)(3) and 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder.
- B. Respondent Mokros cease and desist from committing or causing any violations and any future violations of Sections 17(a)(3) and 17A(c)(2) of the Exchange Act and Rules 17Ac2-1(a) and (c) thereunder.
- C. Respondents Empire and Mokros are censured.
- D. Respondents Empire and Mokros shall jointly and severally pay civil penalties of \$50,000 to the United States Treasury. Payment shall be made in the following installments: \$12,500 within 10 calendar days of the entry of this Order; \$12,500 within 120 calendar days of the entry of this Order; \$12,500 within 240 calendar days of the entry of this Order; and \$12,500 within 360 calendar days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any

additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

- (1) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Empire and Mokros as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine Echavarria, Associate Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Suite 1100, Los Angeles, California 90036.

E. Respondent Empire shall comply with the undertakings enumerated in Section III, Paragraphs 13-18 above.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71908 / April 8, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3814 / April 8, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15830

In the Matter of

HERBERT STEVEN FOUKE,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION 15(b)
OF THE SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE INVESTMENT
ADVISERS ACT OF 1940
AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Herbert Steven Fouke ("Respondent" or "Fouke").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. At the time of the relevant conduct and from September 2008 to April 2009, Respondent was a registered representative at, and a person associated with, Brookstone Securities, Inc., also d/b/a Brookstone Investment Advisory Services, a firm that was located in Lakeland, Florida and was formerly registered with the Commission as a broker-dealer and an investment adviser. Respondent, 55 years old, is a resident of Lafayette, Louisiana.

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B. RESPONDENT'S CRIMINAL CONVICTION

2. On September 6, 2013, Fouke pleaded guilty to one count of conspiracy in violation of Title 18 United States Code, Section 371 before the United States District Court for the Western District of Louisiana, in *United States v. Buswell et al*, Crim. No. 6:11-cr00198-RTH-PJH. Fouke is currently awaiting sentencing.

3. Pursuant to the plea agreement, Fouke admitted that he was present at meetings when Richard J. Buswell ("Buswell"), his co-defendant, made false statements to clients regarding Buswell's credentials, the commissions he would charge, and the rates of returns that he guaranteed the clients would receive. According to the plea agreement, when Buswell made the statements Fouke was not aware of their falsity; however, at some point he became aware that the statements were false. Fouke also became aware that Buswell did not explain the high risk nature of various Direct Private Placements that were recommended to clients. He also became aware that information about the clients' net worth and income had been falsified on Bowman Investment Group LLC forms, so some of the clients would appear to be accredited investors when, in fact, they were not. Fouke also became aware that Buswell did not explain the risks of trading on margin to clients.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act; and

D. Whether, pursuant to Section 15(b) of the Exchange Act, it is appropriate and in the public interest to bar Respondent from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock; or inducing or attempting to induce the purchase or sale of any penny stock.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3815 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15831

In the Matter of

**JAMES ALEXANDER
SHEPHERD,**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against James Alexander Shepherd ("Respondent" or "Shepherd").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

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1. Shepherd was the president of Shepherd Capital Management, LLC, an investment adviser registered with the Securities and Exchange Commission from June 2001 until June 2007. Shepherd, 58 years old, is a resident of Pinehurst, North Carolina.

2. On July 11, 2013, Shepherd pled guilty to one count of securities fraud in violation of Title 15 United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5 before the United States District Court for the Western District of North Carolina, in United States v. James Alexander Shepherd, Docket No. 3:13-CR-167 (2013).

3. The Bill of Information containing the count of the securities fraud to which Shepherd pled guilty alleged, among other things, that between 2006 and April 2013, Shepherd defrauded over 100 investors of approximately \$6 million while operating a commodity pool known as the Shepherd Major Play Option Fund L.P. He is alleged to have used investor funds to cover losses in another of his funds, to pay the costs of his investment newsletter, and to fund his lifestyle. The Bill of Information also alleged that Shepherd deceived an accountant into providing independent auditor's reports for the commodity pool by creating false certifications of bank account balances signed by a fictitious bank employee.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Shepherd's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Shepherd be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71907 / April 8, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3813 / April 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15829

In the Matter of

RICHARD J. BUSWELL,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION 15(b)
OF THE SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE INVESTMENT
ADVISERS ACT OF 1940
AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Richard J. Buswell ("Respondent" or "Buswell").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. At the time of the relevant conduct, Respondent was a registered representative at, and a person associated with, Brookstone Securities, Inc., also d/b/a Brookstone Investment Advisory Services, a firm that was located in Lakeland, Florida and was formerly registered with the Commission as a broker-dealer and an investment adviser. Respondent, 45 years old, was a resident of Lafayette, Louisiana; however, he is currently incarcerated at Iberia Parish Jail located in New Iberia, Louisiana pending sentencing.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On July 24, 2013, Buswell pleaded guilty to one count of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Western District of Louisiana, in *United States v. Buswell et al*, Crim. No. 6:11-cr00198-RTH-PJH. Buswell is currently awaiting sentencing.

3. The count of the criminal indictment to which Buswell pleaded guilty alleged, among other things, that Buswell defrauded investors and obtained money and property by means of materially false and misleading statements. Pursuant to the plea agreement, Buswell admitted that he engaged in excessive and frequent stock transactions on his clients' accounts for his own benefit. He also admitted that he exaggerated guaranteed rates of returns in communications with his clients. Additionally, he admitted that he placed a number of his client in Direct Private Placements even though he knew that the investments were unsuitable. He further admitted that he failed to explain the risks of these investments to his clients and falsified Bowman Investment Group LLC account applications to make the clients appear to be accredited investors when, in fact, they were not. The misconduct underlying the criminal charges occurred during the period in which the Respondent was associated with a registered investment adviser and a registered broker-dealer.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act; and

D. Whether, pursuant to Section 15(b) of the Exchange Act, it is appropriate and in the public interest to bar Respondent from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock; or inducing or attempting to induce the purchase or sale of any penny stock.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and

before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Chair White
Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71916 / April 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15832

In the Matter of

HEWLETT-PACKARD
COMPANY,

Respondent.

ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Hewlett-Packard Company ("HP Co." or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over it and the subject matter of these proceedings and to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order") as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. From approximately 2003 to 2010 (the "relevant period"), HP Co.'s indirect, wholly-owned subsidiaries in Russia, Mexico and Poland, by and through their employees, agents and intermediaries, made unlawful payments to various foreign government officials to obtain business. These payments were also falsely recorded in the subsidiaries' books and records and, ultimately, in HP Co.'s books and records. In Russia, HP Co.'s subsidiary ("HP Russia") made payments through HP Russia's agents to a Russian government official to retain a multi-million dollar contract with the federal prosecutor's office. The payments were made through shell companies engaged by the agents to perform purported services under the contract. In Poland, certain agents or employees of HP Co.'s Polish subsidiary ("HP Poland") provided gifts and cash bribes to a Polish government official to obtain contracts with Poland's national police agency. In Mexico, HP Co.'s Mexican subsidiary ("HP Mexico") made improper payments to a third party in connection with a sale of software to Mexico's state-owned petroleum agency. HP Co. and its consolidated subsidiaries (collectively, "HP") earned approximately \$29 million in illicit profits as a result of this improper conduct.

2. The payments and improper gifts to government officials made directly or through intermediaries were falsely recorded in the relevant HP subsidiaries' books and records as legitimate consulting and service contracts, commissions, or travel expenses. In fact, the true purpose of the payments and gifts was to make improper payments to foreign government officials to obtain lucrative government contracts for HP. During the relevant period, HP lacked sufficient internal controls to detect and prevent the improper payments and gifts made by executives and representatives of certain of its foreign subsidiaries.

Respondent

3. **Hewlett-Packard Company**, a Delaware corporation with its principal place of business in Palo Alto, California, manufactures personal computers, printers and software and provides related information technology services. HP Co.'s common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Entities

4. **ZAO Hewlett-Packard A.O.** ("HP Russia") is an indirect, wholly-owned subsidiary of HP Co. headquartered in Moscow, Russia. HP Russia's books, records and accounts are consolidated into HP Co.'s books and records and reported by HP Co. in its financial statements.

5. **Hewlett-Packard Polska, Sp. z o.o.** ("HP Poland") is an indirect, wholly-owned subsidiary of HP Co. headquartered in Warsaw, Poland. HP Poland's books, records and accounts are consolidated into HP Co.'s books and records and reported by HP Co. in its financial statements.

6. **Hewlett-Packard México, S. de R.L. de C.V.** ("HP Mexico") is an indirect, wholly-owned subsidiary of HP Co. headquartered in Mexico City, Mexico. HP Mexico's books, records and accounts are consolidated into HP's books and records and reported by HP in its financial statements.

Background

7. HP is a global provider of personal computers, printers, software and related information technology infrastructure and services. HP operates through wholly-owned or indirect subsidiaries. During the relevant period, HP sold its products and services through its subsidiaries and through distributors and re-sellers worldwide. The financial statements of each of HP's subsidiaries are consolidated into HP Co.'s financial statements.

8. HP's global operations are organized by geographic regions and sub-regions, as well as business units. Employees in HP's foreign subsidiaries may report to a supervisor in both their geographic region and their business unit. During the relevant period, HP's foreign subsidiaries operated pursuant to compliance policies and directives developed by HP and implemented at the local subsidiary level by the country or regional management. Although HP had certain anti-corruption policies and controls in place during the relevant period, those policies and controls were not adequate to prevent the conduct described herein and were insufficiently implemented on the regional or country level. Further, HP failed to devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurance that: (1) access to assets was permitted only in accordance with management's authorization; (2) transactions were recorded as necessary to maintain accountability for assets; and (3) transactions were executed in accordance with management's authorization.

Unlawful Payments in Russia

9. Between approximately 2000 and 2007, HP Russia promised to pay and did pay bribes through a series of agents and consultants to foreign government officials in Russia in order to win a government tender for computer hardware and software worth more than €35

million. The contract was expected to be the first phase of a larger project that contemplated subsequent tenders with a total estimated value in excess of \$100 million.

10. In or about December 2000, the Russian government announced a project to automate the telecommunications and computing infrastructure of the Office of the Prosecutor General of Russia (the "GPO Project"). The GPO Project represented an opportunity for HP Russia to become a more significant player in the Russian government sector. In addition to the GPO Project's potential \$100 million price tag, which would have been the largest transaction ever for HP in the region, HP Russia executives believed that the project was the "golden key" that could lead to substantial additional business with other Russian state entities.

11. The GPO utilized a state-owned entity organized within the Executive Branch of the Russian Government ("Russian SOE 1") to manage the GPO Project tender and execution.

12. In order to win the GPO Project tender, HP Russia executives agreed to partner with a series of third party intermediaries who had close ties to Russian officials overseeing the tender. In December 2000, the principal of a small U.S. company with ties to the Russian government officials (the "U.S. Agent") approached HP Russia executives and warned that the deal was in jeopardy but that he could assist HP Russia in winning the tender. HP Russia agreed to pay this agent as much as \$1.2 million if the deal went forward. HP Russia also promised to use the U.S. Agent as the principal subcontractor on the deal responsible for, among other things, hiring the subcontractors to supply the hardware, software and installations services to the GPO.

13. In January 2001, HP Russia was awarded the GPO Project tender by Russian SOE 1. In June 2001, HP Russia's Country Manager for the relevant business unit signed the GPO contract on behalf of HP pursuant to a power-of-attorney. In late 2002, the Russian Government switched the method of financing utilized for the GPO Project.

14. Because the Russian government initially sought to finance the project through a guarantee from a U.S. government-backed export bank, the deal had to meet certain U.S. content requirements. As a result, HP Co., the parent company in the U.S., agreed to serve as the contracting party on the deal.

15. HP's International Business Center ("IBC") in the U.S. typically handled the coordination and logistics for contracts that required exporting products from the U.S. to foreign countries. IBC's role was, among other things, to ensure that the products were properly manufactured and shipped overseas, conduct due diligence on any subcontractors engaged on the project, and ensure that HP complied with U.S. content requirements. HP Russia, however, requested that the U.S. agent act as principal subcontractor on the deal.

16. During 2001 and 2002, IBC employees raised questions about the U.S. Agent's size and capabilities to handle such a large, complex project, including its role on the project, the

services it was to perform, and the payments that HP Russia intended to make to it under the GPO contract. They told the HP Russia employees that they would not approve the transaction until these questions were answered. When the IBC employees conducted due diligence on the U.S. Agent, they learned from public records that the agent appeared to be in the medical supply business and had an annual income of only a few hundred thousand dollars. Before the HP Russia employees answered IBC's questions, U.S. financing fell through and the deal moved to Europe.

17. After the GPO encountered problems securing financing with the U.S. bank, in 2003 a German bank agreed to guarantee financing on the GPO transaction. The general terms of the deal remained the same, except that the contract was now valued in euro and required German, not U.S., content. HP Russia also replaced the U.S. agent with a German company to satisfy German content requirements. A new Russian government agency ("Russian SOE 2") also took over responsibility for managing the GPO tender, replacing Russian SOE 1. Oversight of the project moved to an HP subsidiary in Germany, Hewlett-Packard ISE GmbH ("HP ISE"), and employees at the parent company had no further role.

18. Following the change in financing and management, Russian officials considered issuing a new tender and re-opening the bidding. Afraid that they might lose the deal, in April 2003, certain HP Russia executives and representatives promised to make improper payments of approximately €2.8 million to a government official at Russian SOE 2 who was responsible for managing the project on behalf of the GPO. HP Russia executives agreed to make the payments through a German agent who would act as the pass-through for the bribes. The German agent was purportedly responsible for, among other things, hiring other subcontractors to supply the hardware, software and installation services to the GPO. The promise to make the improper payments to the Russian government official through the German agent was approved by HP Russia's country manager for the relevant business group. Approximately €8 million was passed through the German agent to various shell companies, at least one of which was associated with a senior official of Russian SOE 2.

19. Due to the German content requirements, when the contract was reissued, HP ISE replaced HP Co. as the contracting entity on the deal and HP Russia employees continued to manage the project.

20. On August 1, 2003, HP Russia's country manager for the relevant business unit signed the contract on behalf of HP ISE with no authorization and no power of attorney. The country manager also bypassed an internal HP approval process for large projects which was supposed to provide HP with visibility into pricing, discounts, and profit margins for transactions. When HP ISE's management learned three months later that the country manager had already signed the contract without the appropriate review or authorization, they ratified the contract through a retroactive power of attorney.

21. In order to hide the improper payments, the HP Russia employees maintained two sets of project pricing records: (i) an internal set of documents that identified the recipients of the improper payments, and (ii) a sanitized version of the same documents that were provided to management in the credit, finance, and legal offices outside of HP Russia. One example of this was a password-protected spreadsheet maintained by the HP Russia employees. The HP Russia internal version of the spreadsheet included a column labeled "Other Costs" which broke out the €8 million being passed through the German agent, including €2.8 million to be paid to a shell company associated with an employee of Russian SOE 2, and another €2 million labeled "Gosorgony" (the Russian term for state agencies). The spreadsheet circulated to management and other employees had no references to either the shell company or "Gosorgony." A second document used to track the payments was a financial spreadsheet template designed to identify transaction revenues and costs for HP. The internal HP Russia version of the financial spreadsheet included a page titled "Passthrough Activity," which reflected the same breakout of the €8 million being passed through the agent and indicated that the payments would be hidden by including them in the hardware costs of the contract. The version of the financial spreadsheet provided to management outside Russia omitted all references to the "Passthrough Activity" and instead reflected only the inflated hardware prices.

22. HP Russia's credit officer assigned to conduct the approval review for the GPO deal initially denied credit approval for the German agent in October 2003. HP Russia's credit officer questioned the purpose of the €8 million markup being paid to the German agent. She also questioned the role of the subcontractors on the deal. A member of the HP Russia deal team falsely responded that the entire €8 million was for services that the German agent or its subcontractors would perform, including "organization of work in Germany," "processing," "consolidation of equipment," "dispatch of goods to Russia" and "performance of work to install the equipment." The credit officer asked the HP Russia deal team to provide, among other things, "exact names of all [subcontractors]," their "roles in the project," and "payment terms." In response, a member of the HP Russia deal team provided a list of purported subcontractors, including the German agent. However, the list did not identify the payment entities that were included on the internal documents maintained by HP Russia sales employees. Despite the questions raised about the subcontractors and the €8 million markup being paid to the German agent, the deal went forward without any meaningful due diligence on the German agent.

23. Over the course of the GPO Project, more than €21 million flowed through the German agent. The German agent kept less than €200,000 of that amount, passing the rest on to other parties. Although some of the funds went to pay for goods and services actually provided under the contract, a portion of the €8 million paid to the German agent went to shell companies that performed no services. Over the course of the GPO Project, the German agent funneled more than €311,000 to bank accounts associated with the Russian government official. Another

€2.2 million was wired to the Latvian and Lithuanian accounts of other shell companies and used to purchase expensive jewelry, luxury automobiles, travel, and other items.

24. The payments to the agent were falsely recorded in HP Russia's books and records as hardware costs or payments to subcontractors for legitimate services under the GPO Project. HP earned approximately \$10.4 million in illicit profits on the GPO Project.

Unlawful Payments in Poland

25. From approximately 2006 through at least 2010, HP Poland, acting through certain of its agents or employees, made improper payments to one or more public officials in order to secure and maintain lucrative government contracts. These contracts were with the Komenda Główna Policji ("KGP"), the Polish national police agency.

26. Prior to 2006, the KGP had awarded a number of public tenders to HP Poland and its local partners. In or around 2006, a new KGP official – the Director of Information and Communications Technology (the "Polish IT Official") – assumed responsibility for reviewing previously-awarded technology contracts and awarding future contracts.

27. In or around October 2006, HP Poland invited the Polish IT Official to a technology industry conference in San Francisco, California. Certain HP Poland employees, including HP Poland's District Manager of Public Sector Sales and Public Sector Sales Lead (the "HP Poland Executive"), attended as well. Over the course of the trip, the HP Poland employees circumvented HP's internal controls in several respects to develop an improper relationship with the Polish IT Official.

28. The weekend before the conference, HP Poland employees paid for dinners, gifts and sightseeing by the Polish IT Official in San Francisco. On the third day of the conference, they took the Polish IT Official on a sightseeing trip to Las Vegas, Nevada, with no legitimate business purpose. The HP Poland employees paid for various of the Polish IT Official's expenses, including drinks, dining, and a private tour flight over the Grand Canyon. In circumvention of HP's internal controls, the HP Poland employees paid for many of these expenses in cash, without authorization, and failed to document them in HP's books and records accurately.

29. Upon returning to Poland, the HP Poland Executive and the Polish IT official met frequently to discuss HP Poland's existing and future business opportunities with the KGP. Beginning in late 2006, one or more HP Poland employees began giving technology products to the Polish IT official for personal use. Early gifts included HP products, such as desktop and laptop computers, and over time expanded to include, among other things, additional HP computers and devices, iPods, flat screen televisions, cameras, and a home theater system.

These gifts violated HP internal controls relating to gift-giving, and expenses associated with these gifts were not accurately recorded in HP Poland's books and records.

30. In or about January 2007, shortly after receiving the first gifts, the Polish IT Official signed a contract on behalf of the Polish government with HP Poland valued at approximately \$4.3 million. The next month, the Polish IT Official signed another contract with HP Poland valued at approximately \$5.8 million. The KGP awarded both contracts, which were for technology services and HP products, using "single source" bidding procedures.

31. Around the date of the second contract award, one or more HP Poland employees and agents expanded the bribes to include large cash payments from off-the-books accounts and agreed to pay the Polish IT Official 1.2% of HP Poland's net revenue on any contract awarded by the KGP.

32. In or about March 2007, the Polish IT Official signed a KGP contract with HP Poland valued at approximately \$15.8 million. Around this date, the HP Poland Executive left a bag containing \$150,000 in cash at the Polish IT Official's home. On another occasion in 2007, the HP Poland Executive gave the Polish IT Official \$100,000 in cash in a Warsaw parking lot.

33. In 2008, the HP Poland Executive gave the Polish IT Official bags of cash on at least four occasions totaling approximately \$360,000. That year the Polish IT Official signed three contracts on behalf of the Polish government with HP Poland. These agreements, executed in or about January, April and May 2008, were valued at approximately \$32 million in total.

34. One or more HP Poland employees facilitated the corrupt relationship with the Polish IT Official through covert means. In one method, the HP Poland Executive established multiple anonymous e-mail accounts and shared the passwords with the Polish IT Official so that he could write and save messages as "drafts" within the account. The HP Poland Executive also provided the Polish IT Official with pre-paid mobile telephones. The HP Poland Executive and the Poland IT Official also met in remote locations where they would communicate silently by typing on a laptop computer. These messages addressed, among other topics, information about upcoming tenders and bribe amounts.

35. In mid-2008, the Polish IT Official was promoted to a new position within the Polish Interior Ministry, where he was responsible for information technology projects. In mid-2009, the HP Poland Executive paid the Polish IT Official approximately \$6,000 in cash.

36. Sometime thereafter, the HP Poland Executive offered to pay the Polish IT Official to help secure a new contract with the KGP. The contract was ultimately awarded to HP Poland in or about April 2010, and was valued at approximately \$4 million. The contract was signed by two of the Polish IT Official's former subordinates. Despite the prior agreement, no

employee or agent of HP Poland ultimately paid the Polish IT Official any money related to this award.

37. In total, between approximately 2006 and 2010, HP Poland employees and agents provided the Polish IT Official at least \$600,000 in cash, gifts worth more than \$30,000, and several thousand dollars in travel and entertainment benefits. During this same period, the Polish government directly awarded HP Poland at least seven contracts for KPG-related information-technology products and services, with an overall value of approximately \$60 million.

38. HP's internal controls were inadequate to, and did not, detect or prevent improper payments to the Polish IT Official over the course of almost four years. HP Poland's books and records also falsely recorded the payments in its books and records during this period. HP earned approximately \$16.1 million in illicit profits on the KGP contracts.

Unlawful Payments in Mexico

39. In 2009, HP Mexico paid a commission to an entity with ties to Mexican public officials in connection with HP's bid to obtain lucrative government contracts.

40. Beginning in mid-2008, the HP Mexico sales team began pre-sales activities and discussions with Petroleos Mexicanos, Mexico's state-owned petroleum company better known as Pemex, for the sale of a suite of business technology optimization software, hardware, services and licenses. The software and licensing contracts (collectively, the "BTO Deal") were worth approximately \$6 million.

41. HP Mexico sales managers on the BTO Deal knew that they could not win the business without working with, and making payments to, a Mexican information-technology and consulting company that was closely affiliated with senior Pemex officials (the "Mexican Consultant"). As the HP Mexico sales managers knew, Pemex's Chief Operating Officer was a former principal of the Mexican Consultant. HP Mexico's sales managers also knew that the Pemex Chief Operating Officer supervised the Pemex Chief Information Officer, who was a key signatory on behalf of Pemex for the BTO Deal.

42. Although the Mexican Consultant had prior technical experience with Pemex's IT systems, HP Mexico ultimately selected the Mexican Consultant as a channel partner on the BTO Deal primarily because of the Mexican Consultant's connections to Pemex officials. As part of its agreement with the Mexican Consultant, HP Mexico agreed to pay the Mexican Consultant a "commission," which HP Mexico also called an "influencer fee," equal to 25% of the licensing and support components of the BTO Deal.

43. HP Mexico understood from early in the negotiation with Pemex that it had to retain the Mexican Consultant in order to win the Pemex contracts. In one instance, an agent of the Mexican Consultant threatened to take the BTO Deal to one of HP Mexico's competitors if

the Mexican Consultant was not paid its full requested commission. That same agent was a former HP Mexico manager who, several months before, had supervised HP Mexico's sales managers on the BTO Deal team.

44. HP policy governing the payment of commissions to third parties required that the recipients of such payments enter into a written channel partner contract with an addendum permitting the payment of commissions, be pre-approved, subjected to due diligence, and registered in HP's partner system. HP policy also required that channel partner commissions be approved through an approval matrix, with commissions exceeding a particular percentage of the transaction's value requiring additional approvals.

45. The Mexican Consultant was not a pre-approved channel partner of HP Mexico and had not entered into a written channel partner agreement as required by HP's internal controls and policies. Faced with HP's channel partner policy, but needing to pay the Mexican Consultant to win the Pemex business, HP Mexico sales managers arranged for another entity (the "Pass-Through"), which had been previously approved as an HP Mexico channel partner, to step into the transaction. Although the Pass-Through played no role in negotiating or assisting with the BTO Deal, HP Mexico recorded it as the deal partner in its internal tracking system. HP Mexico's sales managers arranged for the Pass-Through to receive the commission from HP Mexico and pass it on to the Mexican Consultant, keeping a percentage as a fee for its own role.

46. Although the introduction of the Pass-Through allowed HP Mexico to pay the Mexican Consultant, it created another problem. Because HP Mexico had committed to paying the Mexican Consultant a commission equal to 25% of the BTO Deal, the maximum permissible without seeking additional approvals under the applicable approval matrix, there was no margin available to compensate the Pass-Through for its role in the deal. As a result, HP Mexico sales managers sought permission from HP regional officials to increase the authorized deal commission by 1.5% to 26.5%. In support of their request, an HP Mexico sales manager sent an email claiming that the Mexican Consultant deserved an increased commission primarily because it had put in extra work and successfully managed discounts with Pemex. The justification omitted any reference to the role of, or payments to, the Pass-Through. The 1.5% increase in the commission was approved by the regional officials on that same day with little or no additional review.

47. On or about December 22, 2008, HP Mexico signed the contracts with Pemex for the BTO Deal. In February 2009, HP Mexico wired approximately \$1.66 million to the Pass-Through pursuant to invoices referencing the Pemex BTO contract. The Pass-Through then transferred approximately \$1.41 million to the Mexican Consultant. The Pass-Through kept the difference as a fee.

48. At least some of this money went to benefit a government official. In March 2009, the Mexican Consultant made cash payments totaling approximately \$125,000 to an entity controlled by Pemex's Chief Information Officer, the public official who had signed the BTO contract.

49. Simply by injecting the Pass-Through in the transaction, HP Mexico sales managers were able to evade HP's policies requiring pre-approval of channel partners and written agreements for third-party payments. In addition, HP Co.'s books and records falsely reflected that the Pass-Through was the deal partner, when in fact the true deal partner was the Mexican Consultant. Moreover, HP Mexico sales managers were able to obtain authorization from HP regional management to pay an additional 1.5% commission payment to the Mexican Consultant without describing the true reason for the increase, which was to pay the Pass-Through for its role in the transaction, further highlighting the lax internal control environment within HP Co. Finally, these various payments to the Mexican Consultant were falsely recorded in HP Mexico's books and records as legitimate commission payments.

50. HP earned approximately \$2.5 million in illicit profits on the BTO Deal.

Additional Conduct

51. In June and July 2006, several European HP subsidiaries, including HP Russia, arranged for a high-profile customer marketing event in connection with the FIFA World Cup soccer tournament in Germany. Despite managerial directives not to invite representatives of government customers, certain HP sales employees arranged for a number of government or state-owned customers to attend the event. In all, HP Russia and other European subsidiaries of HP paid tens of thousands of dollars in travel and entertainment expenses for these government customers, and HP Co.'s internal controls failed to detect or prevent the conduct.

52. Finally, in June 2005, HP Russia paid more than \$2.5 million to a third party distributor for the supply of software and implementation services to a Russian state-owned enterprise. HP Russia's records do not reflect what, if any, work was actually performed by the distributor for these payments, and communications among HP Russia employees suggest that the distributor may have played an influential role in connection with obtaining the contract. The payments to the distributor were recorded in HP Russia's books and records as a payment for providing software and services, even though there was minimal evidence concerning what was actually provided for these payments.

Legal Standards and Violations

A. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder, and upon any other person that is, was,

or would be a cause of the violation, due to an act of omission the person knew or should have known would contribute to such violation.

FCPA Violations

B. Under Section 13(b)(2)(A) of the Exchange Act issuers are required to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. [15 U.S.C. § 78m(b)(2)(A)].

C. Under Section 13(b)(2)(B) of the Exchange Act issuers are required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. [15 U.S.C. § 78m(b)(2)(B)].

D. As described above, HP Co. violated Section 13(b)(2)(A) of the Exchange Act. Its subsidiaries in Russia, Poland and Mexico falsely recorded the payments made to agents as payments for legitimate services or commissions, when the true purpose of these payments was to make corrupt payments to government officials to obtain business. The false entries were then consolidated and reported by HP in its consolidated financial statements. HP Co. also violated Section 13(b)(2)(B) by failing to devise and maintain sufficient accounting controls to detect and prevent the making of improper payments to foreign officials and ensure that payments were made only to approved channel partners.

HP's Remedial Efforts

E. In response to the Commission's investigation, HP retained outside counsel to assist it in conducting an internal investigation into improper conduct in the jurisdictions that were the subject of the staff's inquiry, as well as in other jurisdictions where HP identified additional issues. HP cooperated with the Commission's investigation by voluntarily producing reports and other materials to the Commission staff summarizing the findings of its internal investigation. HP also cooperated by, among other things, voluntarily producing translations of numerous documents, providing timely reports on witness interviews, and by making foreign employees available to the Commission staff to interview.

F. HP has also undertaken significant remedial actions over the course of the Commission's investigation, including by implementing a firm-wide screening process for its channel partners, training its public sector sales staff on its policies for dealing with business

intermediaries, increasing compliance-related training for its global work force, and implementing additional enhancements to its internal controls and compliance functions. In addition, HP took disciplinary actions against certain of its employees in response to the conduct identified by the Commission staff and by the company through its internal investigation.

Criminal Disposition

G. HP's indirect, wholly-owned subsidiaries have entered into dispositions with the United States Department of Justice to resolve potential criminal liability for conduct relating to certain of the findings in the Order, namely a Plea Agreement by HP Russia, a Deferred Prosecution Agreement involving HP Poland, and a Non-Prosecution Agreement involving HP Mexico.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent HP Co.'s Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent HP Co. cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of \$29,000,000 and prejudgment interest of \$5,000,000 to the United States Treasury. \$2,527,750 of Respondent's disgorgement obligation will be satisfied by Respondent's payment of \$2,527,750 in forfeiture as part of HP Mexico's resolution with the United States Department of Justice. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- 1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- 2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- 3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Hewlett-Packard Company as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Tracy L. Davis, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

C. Respondent shall report to the Commission staff periodically, at no less than twelve-month intervals during a three-year term, the status of its remediation and implementation of compliance measures. Should Respondent discover credible evidence, not already reported to the Commission staff, that questionable or corrupt payments or questionable or corrupt transfers of property or interests may have been offered, promised, paid, or authorized by Respondent entity or person, or any entity or person while working directly for Respondent, or that related false books and records have been maintained, Respondent shall promptly report such conduct to the Commission staff. During this three-year period, Respondent shall: (1) conduct an initial review and submit an initial report, and (2) conduct and prepare at least two (2) follow-up reviews and reports, as described below:

- 1) Respondent shall submit to the Commission staff a written report within one (1) year of the entry of this Order setting forth a complete description of its Foreign Corrupt Practices Act ("FCPA") and anti-corruption related remediation efforts to date, its proposals reasonably designed to improve the policies and procedures of Respondent for ensuring compliance with the FCPA and other applicable anti-corruption laws, and the parameters of the subsequent reviews (the "Initial Report"). The Initial Report shall be transmitted to Tracy L. Davis, Assistant Director, Division of Enforcement, United States Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104. Respondent may extend the time period for issuance of the Initial Report with prior written approval of the Commission staff.
- 2) Respondent shall undertake at least two (2) follow-up reviews, incorporating any comments provided by the Commission staff on the previous report, to further monitor and assess whether the policies and procedures of Respondent are reasonably designed to detect and prevent violations of the FCPA and other applicable anti-corruption laws (the "Follow-up Reports").
- 3) The first Follow-up Report shall be completed by no later than one (1) year after the Initial Report. The second Follow-up Report shall be completed by no later than one

- (1) year after the completion of the first Follow-up Report. Respondent may extend the time period for issuance of the Follow-up Reports with prior written approval of the Commission staff.
- 4) Respondent's reporting obligations pursuant to the Order, and its concurrent reporting obligations pursuant to the resolutions of certain of its subsidiaries with the U.S. Department of Justice, shall each be satisfied by the simultaneous submission of the same reports to both the Commission staff and the Department of Justice.
- 5) The periodic reviews and reports submitted by Respondent will likely include proprietary, financial, confidential, and competitive business information. Public disclosure of the reports could discourage cooperation, impede pending or potential government investigations or undermine the objectives of the reporting requirement. For these reasons, among others, the reports and the contents thereof are intended to remain and shall remain non-public, except (1) pursuant to court order, (2) as agreed by the parties in writing, (3) to the extent that the Commission staff determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties and responsibilities, or (4) is otherwise required by law.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71926 / April 10, 2014

Admin. Proc. File No. 3-15769

In the Matter of the Application of

Ricky D. Mullins
Westlake, TX 76262
and
Southlake, TX 76092

for Review of Disciplinary Action Taken by FINRA

**ORDER GRANTING
MOTION TO DISMISS
APPLICATION FOR REVIEW**

Ricky D. Mullins, formerly a registered representative associated with M & W Financial, Inc., a former FINRA member firm, seeks review of a FINRA disciplinary action. FINRA barred Mullins from associating with any FINRA member in any capacity, effective January 24, 2014, because he failed to comply with requests, made pursuant to FINRA Rule 8210,¹ that he appear for additional on-the-record testimony. On March 11, 2014, FINRA filed a motion to dismiss Mullins's application for review, arguing that Mullins failed to exhaust his administrative remedies. For the reasons set forth below, we have determined to grant FINRA's motion and dismiss the appeal.

I. Background

A. Mullins failed to appear for an on-the-record interview requested by FINRA pursuant to FINRA Rule 8210.

On October 10, 2012, FINRA received an anonymous complaint involving Mullins and Guardian Direct Energy Programs, Inc., a broker-dealer that Mullins founded in May 2009 to

¹ FINRA Rule 8210(a)(1) states, in relevant part, that FINRA staff has the right to "require a member, person associated with a member, or any other person subject to FINRA's jurisdiction to provide information orally, in writing, or electronically . . . and to testify at a location specified by FINRA staff, under oath or affirmation administered by a court reporter or a notary public if requested, with respect to any matter involved in the investigation."

promote and sell interests in oil and gas operations.² The complaint stated that, from December 2011 through October 2012, Guardian Direct had promoted an offering that sold limited partnership interests in certain oil and gas operations to the investing public, and that the offering might be a fraudulent scheme that was "[r]aising money with new offerings to keep past partnerships out of default."

After receiving the complaint, FINRA initiated an investigation into the offering. As part of its investigation, Mullins appeared for on-the-record-testimony, pursuant to FINRA Rule 8210, in FINRA's Dallas, Texas district office on May 2, 2013. At the conclusion of the on-the-record-testimony, Mullins agreed that he would supply FINRA with additional information and documents and provide additional testimony at a later date.

FINRA sent Mullins several follow-up Rule 8210 requests, including one request for information and documents sent on September 3, 2013 that stated, "It is possible that the staff will need to request your presence at a second on-the-record interview. In consideration of past scheduling difficulties, please provide possible dates and times of your availability." Although Mullins responded to the Rule 8210 request with written answers to questions and supporting documents, he did not provide dates on which he would be available for a second on-the-record interview. Instead, he wrote, "Odds are that I won't go on the record again until after the SEC is done with me. I understand that I will be subject to sanctions."

On October 9, 2013, FINRA sent Mullins a Rule 8210 request that he appear for on-the-record testimony in FINRA's district office in Dallas, Texas on October 18, 2013. The request cautioned Mullins, "If you fail to appear and testify at the ORT [on-the-record testimony] you may be subject to a FINRA disciplinary action and the imposition of sanctions, including a bar from the securities industry, suspension, censure, and/or fine."

FINRA sent this request by first class and certified mail to Mullins's Westlake, Texas address of record in the Central Registration Depository ("CRD"), which he was required to keep current,³ and to an alternate address in Southlake, Texas that was listed in a LexisNexis public

² Mullins served as Guardian Direct's Chief Executive Officer and Chief Compliance Officer, and registered with FINRA as the firm's Direct Participation Programs Principal, Direct Participation Programs Representative, and Operations Professional. Mullins associated with Guardian Direct until February 2013, when the firm filed a Form BDW (Uniform Request for Broker-Dealer Withdrawal) to cease operations and terminate its registration with FINRA.

³ As part of the registration process, associated persons are required to sign and file with FINRA a Form U4, which obligates them to keep a current address on file with FINRA at all times. *Perpetual Sec., Inc.* Exchange Act Release No. 56613, 2007 SEC LEXIS 2353, at *35 (Oct. 4, 2007); *Nazmi C. Hassanieh*, Exchange Act Release No. 35029, 52 SEC 87, 1994 SEC LEXIS 3862, at *8 (Nov. 30, 1994). A notice issued pursuant to Rule 8210 is deemed received by such person when mailed to the individual's last known CRD address. FINRA Rule 8210(d). This requirement also applies, as here, to former members and associated persons. *See NASD* (continued...)

records database as his "current address." FINRA also sent this request to an email address that Mullins had provided to FINRA staff. The certified mail return receipts for the CRD and alternate addresses contained the same signature, but the signature was illegible. In addition, the certified mail receipt for the CRD address noted that the alternate address was the correct address of delivery. The first-class mailings were not returned.

Mullins responded approximately one hour after he received the emailed copy of the request to appear. In a reply email, Mullins notified FINRA, "I won't be appearing." On October 18, 2013, the day of the scheduled testimony, Mullins did not appear. FINRA staff went on the record to document that Mullins did not appear to provide testimony as requested in the October 9, 2013 letter.

B. FINRA sanctioned Mullins.

After suspending Mullins and warning him of the consequences of noncompliance, FINRA barred Mullins from association with any FINRA member firm for his failure to comply with the Rule 8210 request to appear for an on-the-record interview. First, on October 21, 2013, FINRA notified Mullins in writing, pursuant to FINRA Rule 9552, that it intended to suspend him from associating with any FINRA member firm in any capacity on November 14, 2013, unless he took corrective action before that date by complying with the FINRA Rule 8210 requests to appear for on-the-record testimony.⁴ The notice advised Mullins that he could

(...continued)

Notice to Members 97-31, 1997 NASD LEXIS 35, at *1-2 (May 1997) (reminding associated persons to keep a current mailing address with NASD "[f]or at least two years *after* an individual has been terminated by the filing of . . . [a] Form U5") (emphasis in original).

⁴ FINRA Rule 9552(a) states that if an associated person fails to provide the staff with requested information or testimony pursuant to FINRA rules, FINRA staff may provide written notice to the associated person "specifying the nature of the failure and stating that the failure to take corrective action within 21 days after service of the notice will result in [a] suspension." FINRA Rule 9552(b) provides for service of a notice of suspension in accordance with FINRA Rule 9134, which permits service by both mail and courier service at an individual's residential address as reflected in the CRD.

FINRA served the October 21 notice on Mullins by Federal Express Overnight Delivery and first-class mail to Mullins's CRD and alternate addresses used in sending the earlier Rule 8210 requests. FINRA also sent the notice to Mullins's email address. The Federal Express Overnight Delivery to the CRD address was returned to FINRA. The Federal Express Overnight Delivery to the alternate address was delivered on October 22, 2013. The first-class mailings were not returned. Mullins did not respond to the October 21 notice or otherwise contact FINRA to schedule or appear for on-the-record testimony.

request a hearing to contest the imposition of the suspension which, if timely made, would stay the effective date of the suspension.⁵ The notice warned Mullins that, if the suspension was imposed, FINRA would automatically bar him from associating with any member firm in any capacity on January 24, 2014, unless he requested termination of the suspension based on full compliance with the original request to appear.⁶

Second, on November 14, 2013, FINRA notified Mullins in writing that, as of that date, he was suspended from associating with any FINRA member firm in any capacity.⁷ The notice advised Mullins that an automatic bar would be imposed on January 24, 2014 if he did not fully comply with the notice of suspension, which required him to fully respond to FINRA's request to appear for on-the-record testimony and file a written request to terminate his suspension.

Mullins took no action to challenge his suspension or otherwise attempt to comply with the request to appear, and the automatic bar from associating with any FINRA member firm in any capacity took effect on January 24, 2014. On that date, FINRA sent Mullins a letter notifying him that he was barred and could appeal its decision by filing an application for review with the Commission.⁸ This timely application for review followed.

⁵ FINRA Rule 9559(c) provides, in part, that, "[u]nless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rule 9551 through 9556."

⁶ FINRA Rule 9552(f) permits a suspended individual to file a written request for termination of the suspension on the ground of full compliance with the notice of suspension. FINRA Rule 9552(h) provides that a suspended person who fails to request termination of the suspension within three months of issuance of the original notice of suspension will be barred automatically.

⁷ FINRA served the November 14 notice on Mullins by Federal Express Overnight Delivery and first-class mail to Mullins's CRD and alternate addresses. FINRA also sent the notice to Mullins's email address. The Federal Express Overnight Delivery to the CRD address was returned to FINRA. The Federal Express Overnight Delivery to the alternate address was delivered on November 18, 2013. The first-class mailings were not returned.

Mullins responded approximately one hour after he received the emailed copy of the November 14 notice. In his email reply to FINRA, Mullins stated, "Can you please stop sending mail to the [Westlake] address? I haven't lived there in months. The [Southlake] address is accurate."

⁸ As with its other notices, FINRA sent the January 24, 2014 notice to Mullins by Federal Express Overnight Delivery and first-class mail to Mullins's CRD and alternate addresses. FINRA also sent the notice to his email address. The Federal Express Overnight Delivery to the CRD address was returned to FINRA. The Federal Express Overnight Delivery to the alternate address was delivered on January 27, 2014. The first-class mailings were not returned.

II. Analysis

Given Mullins's failure to contest the sanction before FINRA, we must dismiss Mullins's appeal to avoid undermining the important self-regulatory functions of FINRA. We have emphasized that "[i]t is clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review."⁹ On this basis, we repeatedly have held that "we will not consider an application for review if the applicant failed to exhaust FINRA's procedures for contesting the sanction at issue."¹⁰ As the Second Circuit has reasoned:

Were SRO members, or former SRO members, free to bring their SRO-related grievances before the SEC without first exhausting SRO remedies, the self-regulatory function of SROs could be compromised. Moreover, like other administrative exhaustion requirements, the SEC's promotes the development of a record in a forum particularly suited to create it, upon which the Commission and, subsequently, the courts can more effectively conduct their review. It also provides SROs with the opportunity to correct their own errors prior to review by the Commission. The SEC's exhaustion requirement thus promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress's delegation of authority to SROs to settle, in the first instance, disputes relating to their operations.¹¹

The October 9, 2013 Rule 8210 request warned Mullins that his failure to appear for on-the-record testimony on October 18, 2013 may subject him to a FINRA disciplinary action and the imposition of sanctions, including a bar from the securities industry, suspension, censure, and/or fine. Mullins acknowledged that his failure to appear could subject him to sanctions, but nonetheless informed FINRA, "I won't be appearing."

⁹ *MFS Secs. Corp.*, Exchange Act Release No. 47626, 2003 SEC LEXIS 789, at *22 & n.29 (Apr. 3, 2003) (citing *Royal Secs. Corp.*, Exchange Act Release No. 5171, 36 SEC 275, 1955 SEC LEXIS 94, at *5 (May 20, 1955)), *aff'd*, 380 F.3d 611 (2d Cir. 2004).

¹⁰ *E.g.*, *Mark Steven Steckler*, Exchange Act Release No. 71391, 2014 SEC LEXIS 283, at *8 (Jan. 24, 2014) (dismissing applicant's appeal for failure to exhaust administrative remedies where FINRA barred applicant under Rule 9552 for failing to respond to Rule 8210 information requests); *Gilbert Torres Martinez*, Exchange Act Release No. 69405, 2013 SEC LEXIS 1147, at *11-15 (Apr. 18, 2013) (same); *Norman S. Chen*, Exchange Act Release No. 65345, 2011 SEC LEXIS 3224, at *6, 11 (Sept. 16, 2011) (same); *Gregory S. Profeta*, Exchange Act Release No. 62055, 2010 SEC LEXIS 1563, at *5, 8 (May 6, 2010) (same); *see also MFS Secs. Corp.*, 2003 SEC LEXIS 789, at *21-26 (refusing to consider applicant's denial of access to services claim because applicant failed to exhaust New York Stock Exchange's procedures).

¹¹ *MFS Secs. Corp. v. SEC*, 380 F.3d 611, 621-22 (2d Cir. 2004).

The October 21, 2013 notice stated that FINRA intended to suspend Mullins on November 14, 2013, unless he took corrective action by complying with the Rule 8210 requests. The notice also stated, alternatively, that Mullins could request a hearing, which would have stayed the effectiveness of the suspension. But Mullins did not take corrective action or request a hearing. The October 21 and November 14 notices further informed Mullins that, after the suspension took effect, he could request its termination based on full compliance. As noted, Mullins took no action in response to the notices and allowed the bar to take effect.

In his application for review, Mullins stated that he requested a postponement of his on-the-record testimony until after the Commission completed its investigation of him and Guardian Direct because "the matter is being actively disputed." But the record contains no evidence that Mullins made such a request. After receiving the October 9, 2013 Rule 8210 request, Mullins twice communicated with FINRA. On October 9, 2013, Mullins emailed FINRA to inform the staff that he would not be appearing for testimony. And, on November 14, 2013, Mullins emailed FINRA asking that the staff refrain from sending him correspondence to his CRD address. Neither email to FINRA requested a postponement or otherwise sought to reschedule his on-the-record testimony scheduled for October 18, 2013.

FINRA properly served Mullins with the October 9, 2013 Rule 8210 request to appear and the suspension notices, and Mullins does not claim otherwise.¹² Mullins does not dispute that he failed to appear for his on-the record testimony. Nor does he dispute that he failed to challenge the resulting disciplinary sanction through FINRA's appeal procedures. Under these

¹² Even if Mullins had argued that he did not receive certain FINRA correspondence because he no longer received correspondence at the CRD address—and, as discussed, there is ample evidence that he did receive the notices at issue—that argument would have had no merit. As noted, it was Mullins's responsibility to update his CRD address, as expressly required by FINRA rules, and we have repeatedly held that not doing so is no defense to a failure to respond. *See, e.g., Edward J. Jakubik*, Exchange Act Release No. 61541, 2010 SEC LEXIS 1014 at *16 (Feb. 18, 2010) (finding that applicant was deemed to have received FINRA's default decision that was properly served at his CRD address); *Robert J. Langley*, Exchange Act Release No. 50917, 57 SEC 1125, 2004 SEC LEXIS 3048 at *9 (Dec. 22, 2004) ("Rule 8210(d) does not require NASD to take any affirmative action to track down a registered representative who has failed to provide NASD with a current address"); *Warren B. Minton Jr.*, Exchange Act Release No. 46709, 55 SEC 1170, 2002 SEC LEXIS 2712 at *13 (Oct. 23, 2002) (holding that registered representatives have a "continuing duty" to notify NASD of address changes) (citing cases); *Ashton Noshir Gowadia*, Exchange Act Release No. 40410, 53 SEC 786, 1998 SEC LEXIS 1887 at *11 (Sept. 8, 1998) (finding that registered representative's assumption that member firm had updated his CRD address does not mitigate representative's failure to do so); *Hassanieh*, 1994 SEC LEXIS 3862 at *9 (noting that the obligation to keep CRD address current is crucial to NASD's investigative efforts because, otherwise, investigations "could easily be avoided by an individual's moving without leaving a forwarding address").

circumstances, and given the well-established precedent discussed above, we see no basis for denying FINRA's motion to dismiss.¹³

Accordingly, IT IS ORDERED that FINRA's motion to dismiss the application for review filed by Ricky D. Mullins is GRANTED.

By the Commission.


Jill M. Peterson
Assistant Secretary

¹³ Mullins requests that the Commission "prevent FINRA from publicizing this action." But, under NASD Interpretive Material 8310-3 (Release of Disciplinary Complaints, Decisions, and Other Information), FINRA may release to the public information about any decision issued pursuant to Rule 9550 involving the suspension or bar of an associated person.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71929 / April 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15836

In the Matter of

**AGFEED INDUSTRIES,
INC.,**

Respondent.

**ORDER INSTITUTING PROCEEDINGS
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against AgFeed Industries, Inc. ("AgFeed" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Section 12(j) of the Securities Exchange Act of 1934, Making Findings, and Revoking Registration of Securities ("Order") as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

1. AgFeed (CIK No. 1331427) is a Nevada corporation with its principal place of business in Hendersonville, Tennessee.

2. AgFeed filed for bankruptcy protection on July 15, 2013 in the United States Bankruptcy Court for the District of Delaware and is currently in liquidation. AgFeed's common stock is currently registered with the Commission under Exchange Act Section 12(g). Prior to March 24, 2012, AgFeed's common stock was listed on the The NASDAQ Stock Market LLC under the stock symbol "FEED." AgFeed's common stock is currently quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc. under the ticker symbol "FEEDQ."

3. AgFeed is delinquent in its periodic filings with the Commission and has repeatedly failed to meet its obligation to file timely periodic reports. AgFeed has not filed an Annual Report on Form 10-K since March 16, 2011, or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ended June 30, 2011.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

5. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means of instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.


Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71942 / April 14, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15838

In the Matter of

STEVEN J. LITTLE,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Steven J. Little ("Little" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Little, 53 years old, resides in Southlake, Texas. He is the principal of Neveah Energy, LLC ("Neveah"). On June 18, 1985, Little entered into a Stipulation and Consent Cease and Desist Order with the State of Florida, Office of Financial Regulation, Division of Securities in which he agreed not to sell or offer for sale any unregistered oil and gas securities in, or from offices in, Florida unless properly registered. In the mid-1980's, Little briefly held a Series 6 and Series 26 license and was a registered representative of a broker-dealer. Little is not currently registered with the Commission or FINRA.

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2. On March 31, 2014, a judgment was entered by consent against Little, permanently enjoining him from future violations of Sections 17(a)(2) & (3), 5(a), and 5(c) of the Securities Act of 1933 and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Joshua D. Spivey, et al., Civil Action Number 3:14-CV-1106-D, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged, among other things, that between September 2009 and May 2010, Little acted as an unregistered broker-dealer and conducted unregistered securities offerings of working interests in Halek Energy, LLC ("Halek Energy") oil and gas projects. The offering documents for Halek Energy contained false and misleading information which operated as a fraud and deceit on investors. In connection with these offerings, Little received sales commissions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Little be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71943 / April 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15839

In the Matter of

JOSHUA D. SPIVEY,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joshua D. Spivey ("Spivey" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Spivey, 32 years old, resides in Morristown, Tennessee. He is the principal of Time Talent Treasure Investments, LLC d/b/a T3 Consulting, LLC ("T3"). Spivey has never been registered with the Commission or FINRA and he has no disciplinary history.

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2. On March 31, 2014, a judgment was entered by consent against Spivey, permanently enjoining him from future violations of Sections 17(a)(2) & (3), 5(a), and 5(c) of the Securities Act of 1933 and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Joshua D. Spivey, et al., Civil Action Number 3:14-CV-1106-D, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged, among other things, that between September 2009 and May 2010, Spivey acted as an unregistered broker-dealer and conducted unregistered securities offerings of working interests in Halek Energy, LLC oil and gas projects utilizing unregistered third-party salesmen. The offering documents used by Spivey to solicit investors contained false and misleading information which operated as a fraud and deceit on investors. In connection with these offerings, Spivey received sales commissions.

IV.

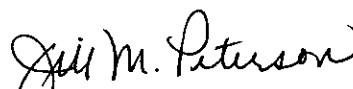
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Spivey be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71944 / April 14, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15840

In the Matter of

PATRICK J. BOOTHES,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Patrick J. Booths ("Booths" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Booths, 48 years old, resides in Fort Worth, Texas and was the Vice-President, Marketing & Sales for Halek Energy, LLC ("Halek Energy"). Booths has never been registered with the Commission or FINRA.

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2. On March 31, 2014, a judgment was entered by consent against Booths, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Joshua D. Spivey, et al., Civil Action Number 3:14-CV-1106-D, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged, among other things, that between September 2009 and May 2010, Booths acted as an unregistered broker-dealer and conducted unregistered securities offerings of working interests in Halek Energy oil and gas projects utilizing unregistered third-party salesmen. The offering documents used by Booths to solicit investors contained false and misleading information which operated as a fraud and deceit on investors. In connection with these offerings, Booths received sales commissions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Booths' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9575 / April 15, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71948 / April 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3818 / April 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31017 / April 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15842

In the Matter of

**TOTAL WEALTH MANAGEMENT,
INC., JACOB KEITH COOPER,
NATHAN MCNAMEE, AND
DOUGLAS DAVID SHOEMAKER**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTIONS
15(b) and 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, SECTIONS
203(e), 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940 AND NOTICE OF
HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Total Wealth Management, Inc., Jacob Keith Cooper, Nathan McNamee, and Douglas David Shoemaker (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This proceeding involves misconduct by Total Wealth Management, Inc. ("Total Wealth"), a registered investment adviser; its co-founder, sole owner, and CEO, Jacob Keith Cooper ("Cooper"); its current president and chief compliance officer, Nathan McNamee; and its co-founder and former chief compliance officer, David Shoemaker. They engaged in this malfeasance in connection with investments made in the unregistered Altus Capital Opportunity Fund, LP ("Altus Capital Fund") and a series of unregistered fund of funds referred to as the "Altus Portfolio Series" (collectively, with the Altus Capital Fund, the "Altus Funds").

2. Since at least 2009, Total Wealth and Cooper have breached their fiduciary duties to their clients and investors through a fraudulent scheme to collect, and conceal their receipt of, undisclosed revenue sharing fees derived from investments they recommended to their clients. Total Wealth, Cooper, McNamee, and Shoemaker each received undisclosed revenue sharing fees, which were funneled through entities created by the individuals to mask their receipt of the fees. In addition, Total Wealth and Cooper materially misrepresented to investors and clients the extent of the due diligence conducted on the investments they recommended. Total Wealth also violated the custody rule by failing to obtain annual audits from an independent public accountant subject to regular inspection by the Public Company Accounting Oversight Board ("PCAOB").

3. McNamee and Shoemaker, two investment adviser representatives with Total Wealth (and former registered representatives) aided, abetted, and caused Total Wealth's and Cooper's violations. McNamee and Shoemaker, who knew about the revenue sharing arrangements and the related misrepresentations, likewise failed to fully disclose those arrangements to clients. Cooper and McNamee also aided, abetted, and caused Total Wealth's custody rule violation.

B. RESPONDENTS

4. Total Wealth is a California corporation with its principal place of business in San Diego, California. Total Wealth registered with the Commission as an investment adviser on November 25, 2009, and has approximately \$90.2 million under management in 481 client accounts. Total Wealth is the owner and managing member of Altus Management and the investment adviser to the Altus Capital Fund and the Altus Portfolio Series Funds.

5. Cooper resides in Washington, Utah. He is the founder, sole owner, and CEO of Total Wealth. He holds Series 6 and 63 licenses. Cooper was a registered representative and associated with two broker-dealers and another investment adviser from 2001 through 2005. He resigned from Sun America Securities, Inc. in 2005, following the settlement of a customer complaint that Cooper forged signatures on account application paperwork and failed to explain the difference between variable life products versus mutual fund products. Thereafter, he co-founded Total Wealth with Shoemaker.

6. McNamee resides in Hurricane, Utah. He has been an investment adviser representative with Total Wealth since 2009. He has served as Total Wealth's president since early 2011 and its chief compliance officer since May 2011. McNamee holds Series 7 and 66 licenses and previously held a Series 63 license. McNamee was a registered representative of Financial Telesis, Inc., a registered broker-dealer, from December 2009 through December 2010.

7. Shoemaker resides in San Diego, California. He is the founder, former chief compliance officer (until 2011), and a current investment adviser representative of Total Wealth. Shoemaker holds a Series 65 license and previously held Series 6 and 63 licenses. Shoemaker was a registered representative and associated with the same broker-dealers and investment adviser as Cooper from 2001 through 2005.

C. OTHER RELEVANT ENTITIES

8. Altus Management is a California limited liability corporation with its principal place of business in San Diego, California. Altus Management is the general partner to the Altus Capital Fund and the Altus Portfolio Series. Altus Management has never registered with the Commission in any capacity and has no disciplinary history with the Commission.

9. The Altus Capital Fund is a California limited partnership and an unregistered fund of funds. It first filed a Form D on January 25, 2010 claiming exemption from registration under Rule 506 of Regulation D of the Securities Act and an exclusion from the definition of "investment company" in Section 3(c)(1) of the Investment Company Act.

10. Altus Conservative Portfolio Series, LP, Altus Focused Growth Portfolio Series, LP, Altus Income Portfolio Series, LP, Altus Moderate Growth Portfolio Series, LP, and Altus Moderate Portfolio Series, LP are a family of California limited partnerships. They are a series of unregistered funds of funds referred to as the "Altus Portfolio Series" (collectively, the "Altus Portfolio Series Funds"). The Altus Portfolio Series Funds filed Forms D in 2011 claiming exemption from registration under Rule 506 and Section 3(c)(1) of the Investment Company Act.

11. Capita Advisors, Inc. ("Capita") is a California corporation with its principal place of business in San Diego, California. Capita purports to be a consulting company, and was founded and is operated solely by McNamee. Capita has never registered with the Commission in any capacity and has no disciplinary history with the Commission.

12. Financial Council, Inc. ("Financial Council") is a California corporation with its principal place of business in San Diego, California. Financial Council purports to be a consulting company, and was founded and is operated solely by Shoemaker. Financial Council has never registered with the Commission in any capacity and has no disciplinary history with the Commission.

13. Pinnacle Wealth Group, Inc. ("Pinnacle") is a California corporation with its principal place of business in San Diego, California. Pinnacle purports to be a consulting company, and was founded and is operated solely by Cooper. Pinnacle has never registered with the Commission in any capacity and has no disciplinary history with the Commission.

D. FACTUAL ALLEGATIONS

1. Background of the Altus Funds

14. Total Wealth, which was founded by Cooper and Shoemaker, is an investment adviser to the Altus Funds. Total Wealth is also the owner and managing member of Altus Management, which is the general partner to the Altus Funds.

15. Cooper organized the Altus Capital Fund in late 2009 in order to allow Total Wealth clients to pool their money to meet the mandatory minimum investment requirement for funds for which they otherwise might not qualify.

16. Two years later, in 2011, Cooper established the Altus Portfolio Series Funds, a series of pooled investment funds. The Altus Funds – Altus Capital Fund and the Altus Portfolio Series Funds – invest their assets in other funds, which are selected by Cooper. The Altus Capital Fund and the Altus Portfolio Series Funds hold many of the same investments.

17. Cooper makes all of the investment decisions and recommendations for Total Wealth clients, including those who invested in the Altus Funds. These clients pay for this advice based on the amount of assets that were being managed. As the CEO and owner of Total Wealth, Cooper directly benefits from the fees Total Wealth receives.

18. Total Wealth identifies potential new clients through paid weekly radio broadcasts, existing client referrals, webinars, the company website, and meet-and-greets through a local speaker's bureau or a free lunch. Prior to the formation of the Altus Capital Fund, existing Total Wealth clients could choose to place their investment funds directly in the offerings recommended by Total Wealth and Cooper.

19. Starting in 2010, Total Wealth and Cooper began advising their preexisting clients to transfer their individual investments to the Altus Capital Fund. At the same time, they also began offering the Altus Capital Fund to new Total Wealth clients and later, in 2011, they began offering the Altus Portfolio Series Funds to Total Wealth clients.

20. Cooper, McNamee, and Shoemaker met with potential investors prior to accepting them as clients of Total Wealth or as investors in the Altus Funds. As investment adviser representatives, they then prepared written investment recommendations and discussed them with their prospective clients. Total Wealth provided clients with prospective investor packets and brochures, including a packet designed specifically for prospective investors in the Altus Funds. The packet frequently included an executive summary of the fund, which was created and approved by Cooper who solicited input from McNamee and Shoemaker. Total Wealth also provided the executive summary to potential investors who participated in webinars.

21. Investors in the Altus Funds typically received an offering memorandum, a limited partnership agreement, and a subscription agreement. In May 2011, when McNamee became the chief compliance officer, he "signed off" on all material provided to prospective investors. The funds' offering memoranda state that Altus Management will "adhere" to the provisions of the Investment Advisers Act. They also specifically state, in all capital letters, that

"provisions referenced to [Altus Management] . . . may also be deemed to apply, and should be read to apply equally to [Total Wealth], and vice versa where relevant."

22. In May 2011, McNamee also assumed responsibility for verifying that all investors received the current Form ADV for Total Wealth. Shoemaker signed the firm's Forms ADV for Total Wealth in 2009 and 2010, Cooper signed the Forms ADV for Total Wealth in 2011, and McNamee signed the Forms ADV for Total Wealth thereafter.

23. Once a client invested in one of the Altus Funds, Altus Management had the discretion to buy and sell that client's holdings without notice. Total Wealth clients who have invested directly in the Altus Funds do not receive offering documents regarding the underlying investments held by the Altus Funds. Instead, they receive statements directly from the Altus Funds (via Total Wealth), and the only offering memorandum that they may see are those of the Altus Funds themselves. As a result, there is little to no transparency provided to investors that would allow them to evaluate the merit of the underlying holdings of the Altus Funds or whether Total Wealth possessed any relationship to those entities. Currently, approximately 75% of Total Wealth's clients are invested in one or more of the Altus Funds. Likewise, approximately 75% of Total Wealth's clients are individuals.

24. As of April 2013, the Altus Capital Fund had a gross asset value of approximately \$43.5 million held for 86 beneficial owners. As of February 2013, the Altus Portfolio Series Funds collectively held gross assets of approximately \$10.9 million.

2. Total Wealth's Revenue Sharing Fee Arrangements

25. Since at least February 2008, prior to the creation of the Altus Capital Fund, Total Wealth had revenue sharing arrangements in place with several investment funds. Under these agreements, these other funds paid Total Wealth a fee when Total Wealth placed its clients' investments in those funds. Cooper signed all of the revenue sharing agreements on behalf of Total Wealth.

26. Total Wealth paid Cooper, McNamee, and Shoemaker a portion of the revenue sharing fees it received. Through written agreements signed by McNamee and Shoemaker, Total Wealth agreed to pay each person 70%-80% of the revenue sharing fees earned for every Total Wealth client he placed into the underling funds. Cooper received his revenue sharing fees without the use of a written agreement.

27. About the same time that the Altus Capital Fund was established, Cooper formed Pinnacle, and he advised Shoemaker and McNamee to form Financial Council and Capita, respectively.

28. Pinnacle, Financial Council, and Capita (the "Side Entities") received in their bank accounts the revenue sharing fees paid to their respective owners, and these Side Entities appear to have had no real business other than receiving these fees. Typically, Cooper, McNamee and Shoemaker funneled their revenue sharing payments through the Side Entities. Cooper simply paid money directly from Total Wealth to Pinnacle. McNamee and Shoemaker issued invoices on behalf of their Side Entities, and these invoices frequently characterized the fees as something other than revenue sharing fees, concealing the true nature of the fees paid.

For example, in 2010, Financial Council, Shoemaker's entity, consistently submitted invoices to Pinnacle, Cooper's entity, for "consulting fees" even though Shoemaker did not do any consulting work.

29. Moreover, because Total Wealth collected the revenue sharing fees, the fees do not appear directly on the Altus Capital Fund's financial statements.

a. The Failure to Disclose the Revenue Sharing Fees and the Conflict of Interest Resulting from These Arrangements

30. Total Wealth and Cooper made materially false misrepresentations and omissions to their clients about the revenue sharing arrangements, the fees received under these arrangements, and the payment of these fees to Cooper, McNamee and Shoemaker.

31. The disclosures in all of the Altus Funds' offering memoranda and, beginning in May 2010, in Total Wealth's Form ADV Part II, Schedule F (later known as Part 2A) merely informed clients that Total Wealth "may" receive revenue sharing fees. But these disclosures failed to inform Total Wealth clients that Total Wealth already was receiving revenue sharing fees and failed to inform the investors about the sources, recipients, amounts and duration of the fees. This language appears in all of Total Wealth's subsequent Forms ADV, including those filed with the Commission.

32. Specifically, Total Wealth's Forms ADV filed March 28, 2011, August 23, 2011, May 2, 2012, February 26, 2013, April 5, 2013, and May 22, 2013 were false when filed. Specifically, the Parts 2A falsely stated that Total Wealth "may have arrangements with certain Independent Managers whereby the Adviser receives a percentage of the fees charged by such Independent Managers." The Forms ADV also do not disclose the revenue sharing fees as one of Total Wealth's "compensation arrangements" in Item 5, nor do they contain any reference to the Side Entities or these entities' affiliations with Total Wealth. A complete list of the false filings, the relevant item numbers, and the person responsible for each filing is attached hereto as Exhibit A.

33. Like the Forms ADV, the Altus Funds' offering memoranda also failed to adequately disclose the revenue sharing arrangements. What little disclosure there is about the arrangements is buried in the memoranda and fails to disclose that Total Wealth routinely earned such fees. For example, page 60 of the Altus Capital Fund memorandum states: "Some Private Funds *may* pay the General Partner or its affiliates a referral fee or a portion of the management fee paid by the Private fund to its general partner or investment adviser, including a portion of any incentive allocation" (emphasis added). Moreover, the existence, rate or prevalence of actual revenue sharing fee arrangements is not listed among the "other fees & expenses" identified in the "Summary of the Offering" placed at the beginning of the memoranda.

34. Respondents also did not disclose the existence, amount or extent of the revenue sharing fees paid to Respondents in other documents and communications. For example, the executive summary and the glossy folder containing the prospective investor packet for the Altus Funds states merely: "The Fund typically charges a fee of 1.4% of assets under management." Yet this disclosure is silent about Total Wealth's receipt of any revenue sharing

fees. Likewise, emails to clients about investment adviser fees and statements issued by Total Wealth to investors did not disclose the revenue sharing fees.

35. These limited disclosures to the investors were misleading. At the time these disclosures were made, Total Wealth already had several revenue sharing arrangements in place. Yet the disclosures failed to disclose the existence of the revenue sharing fee arrangements and misrepresented the truth about these arrangements.

36. The disclosures also failed to adequately disclose that Total Wealth already had a significant number of revenue sharing agreements in place. For example, according to the Altus Capital Fund's audited financial statements, the fund had over \$34 million in investments in fiscal year 2010. Of that amount, \$31.7 million – or about 92% – was invested in entities that had revenue sharing agreements with Total Wealth.

37. Investors viewed the revenue sharing fees as material and would not have invested with Total Wealth if they knew that most of the funds in which the Altus Funds invested were, in turn, paying revenue sharing fees to Total Wealth. Moreover, several of these funds that paid revenue sharing fees were new enterprises and did not have any performance history making them riskier investments. Total Wealth's undisclosed financial incentive (in the form of the revenue sharing arrangements) to invest in such new and untested enterprises was material.

38. Also, many of the underlying investment funds that paid revenue sharing fees to Total Wealth had multi-year "lock-up" periods or set terms that prevented investors from withdrawing their money. So once invested, even if investors had learned about the revenue sharing fees, they would not have been able to obtain their funds.

39. The revenue fee sharing arrangement also created a clear conflict of interest for Total Wealth and Cooper. By receiving these fees for investing their clients into certain funds, Total Wealth and Cooper had an incentive to make those investments regardless of the performance of the underlying fund or the appropriateness of the investment. In fact, Total Wealth and Cooper had a persistent and pervasive practice of recommending and making investments in the underlying funds that paid revenue sharing fees. Doing so created extensive conflicts of interest that Total Wealth and Cooper had a duty to disclose fully.

40. Total Wealth and Cooper did not adequately disclose these conflicts of interest, which affected their ability to provide unbiased advice to their clients to invest in the Altus Funds. Total Wealth and Cooper breached their fiduciary duties to their clients by failing to adequately disclose the material information about the revenue sharing fee arrangements and the conflicts of interest posed by these arrangements.

41. McNamee and Shoemaker aided and abetted Total Wealth's and Cooper's failure to adequately disclose the material information about the revenue sharing fee arrangements, and they aided and abetted Total Wealth's and Cooper's failure to disclose Total Wealth's and Cooper's conflicts of interest that resulted from these arrangements. McNamee and Shoemaker also aided and abetted Total Wealth's and Cooper's breaches of fiduciary duty. As officers of Total Wealth and holders of several securities licenses, McNamee and Cooper

knew, or were reckless in not knowing, that Total Wealth and Cooper had fiduciary responsibilities to their clients.

42. McNamee and Shoemaker knew about the revenue sharing agreements. They received a portion of Total Wealth's revenue sharing fees as a result of agreements that they signed with Total Wealth. McNamee and Shoemaker reviewed the brochures, offering memoranda, statements, Forms ADV and other materials that Total Wealth provided to its clients. McNamee formally signed off on these materials after he replaced Shoemaker as chief compliance officer in 2011. McNamee and Shoemaker also met with prospective clients and investors, prepared investment recommendations for those clients, sold the Altus investments to clients, and collected their portion of the revenue sharing fees. But they failed to disclose the truth about the revenue sharing agreements to investors. As a result, McNamee and Shoemaker substantially assisted Total Wealth and Cooper's failure to sufficiently disclose the fee arrangements and the resulting conflicts.

b. The Scheme to Mislead Investors about the Revenue Sharing Fees

43. Respondents devised and orchestrated a fraudulent scheme to collect and conceal their receipt of revenue sharing fees through their Side Entities. Respondents structured the Altus Funds and their disclosures so the clients investing in the Altus Funds would not know those funds held risky investments paying revenue sharing fees back to the Respondents.

44. Respondents took several steps in furtherance of the scheme. In December 2008, Total Wealth hired a compliance consultant with 15 years of experience in the industry. But Total Wealth fired him after he had prepared early versions of the Form ADV that more fulsomely disclosed the revenue sharing fee arrangements. In fact, although the consultant knew about the revenue sharing fee agreements and asked Shoemaker to see copies of the agreements, the Respondents never provided them to him and the consultant never saw the agreements. Nonetheless, the consultant prepared an October 2009 version of Total Wealth's ADV Part II, Schedule F that stated that Total Wealth "routinely purchases a certain type of security . . . [and] has entered into solicitation agreements with the firms offering the investment product and as a result of placing the client in those investment products, the Adviser may receive a percentage of the investment advisory fees charged by the firm." Total Wealth filed this Schedule F with its Form ADV in October 2009.

45. After the consultant drafted this language disclosing the revenue sharing arrangements, Total Wealth fired him on or around October 2009. Shortly thereafter, Total Wealth hired a rookie compliance consultant with little relevant experience. Then, Total Wealth's May 2010 Schedule F, and all subsequent Forms ADV and accompanying schedules and parts, omitted the language recommended by the fired consultant. Total Wealth did not file its May 2010 Schedule F with the Commission. Total Wealth did, however, file the regulatory replacement to the Schedule F, Part 2A (known as the "firm brochure") in March 2011 along with its Form ADV. The March 2011 Part 2A, and all subsequent Forms ADV and Parts 2A, falsely stated only that Total Wealth "may" have revenue sharing arrangements. As stated above, a complete list of the false filings, the relevant item numbers, and the person responsible for each filing is attached hereto as Exhibit A.

46. Meanwhile, in November 2009, McNamee and Shoemaker, through Capita and Financial Council respectively, began issuing invoices to Cooper that concealed the revenue sharing fees. These false invoices charged “consulting fees” even when the entities performed no consulting work. These false invoices disguised the flow of income from the revenue sharing fees.

47. Also, around the same time that Total Wealth hired the new compliance consultant, it hired a fund administrator to assist with the newly-formed Altus Fund. Like the new compliance consultant, the accountant for the administrator was inexperienced, having no prior experience doing investment fund portfolio accounting. Later, in early to mid-2010, the administrator encountered difficulties obtaining the documents and information from Total Wealth, the Altus Funds, and their underlying funds that were necessary to prepare timely and reliable statement information for Altus Fund investors. On November 30, 2010, Total Wealth terminated its relationship with the fund administrator and subsequently hired an administrator in the Bahamas.

48. In addition, in July 2010, Total Wealth began preliminary discussions with an auditor about auditing the Altus Capital Fund. Total Wealth was required to comply with the Custody Rule, 17 C.F.R. §275.206(4)-2 (the “Custody Rule”). As part of its compliance with the Custody Rule, Total Wealth was required to comply with Sections 206(4)-2(a)(2), (3), and (4) unless it availed itself of the audit exception by obtaining an annual audit from an auditor subject to regular PCAOB inspection. When the proposed new auditor emailed a draft engagement letter to Cooper, it included an excerpt from the SEC’s “Staff Responses to Questions About the Custody Rule” regarding audits of pooled investment vehicles and the Custody Rule, which reiterated the rule’s requirement that the auditor needed to be subject to regular PCAOB inspection. Total Wealth then elected not to hire that auditor.

49. Instead, in late 2010, Total Wealth hired an unqualified accountant (the “Auditing Firm”) to audit the Altus Capital Fund. The owner and sole individual associated with the Auditing Firm did not verify that he or his firm was subject to regular PCAOB inspection, only that he and his firm were subject to “oversight.” As a result, the Auditing Firm could not fulfill Total Wealth’s obligation under the Custody Rule to have audits performed by an auditor subject to regular PCAOB inspection.

50. The Auditing Firm also lacked independence as defined by Regulation S-X. The Custody Rule requires that Regulation S-X independence standards be met for the audit to satisfy the audit exception under the Custody Rule. *See* 17 C.F.R. §§ 275.206(4)-2(b)(4)(ii), 275.206(4)-2(d)(3) (independent public accountant must meet standards of Regulation S-X). As part of the Auditing Firm’s engagement by Total Wealth, the Auditing Firm prepared the Altus Capital Fund’s 2010 financial statements. Then, Total Wealth instructed the Auditing Firm to audit those very financial statements, which it did. Under Regulation S-X, an accountant is not independent if he provides certain bookkeeping and other services related to the accounting records or financial statements unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client’s financial statements. *See* Rule 2-01(c)(4)(i) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(4)(i); *Final Rule: Strengthening the Commission’s Requirements Regarding Auditor Independence*, 68 Fed. Reg.

6006, 6011 (Feb. 5, 2003) (to be codified at 17 C.F.R. pts. 210, 240, 249 and 274) (it is a basic principle that an auditor cannot audit his own work and remain independent).

51. Cooper served as one of the principal contacts for the Auditing Firm and helped the Auditing Firm obtain information that it then used to prepare the financial statements. Cooper reviewed those financial statements and signed the management representation letter.

52. McNamee also served as one of the Auditing Firm's principal contacts during the audit and preparation of financial statements. McNamee helped the Auditing Firm obtain the information that it used to prepare the financial statements, and McNamee reviewed those financial statements.

53. In short, throughout this time period, Total Wealth and Cooper placed investors in the Altus Capital Fund, allowing Cooper, McNamee and Shoemaker to obtain revenue sharing fees. Because Total Wealth, and not the Altus Capital Fund, collected the revenue sharing fees, those fees did not appear directly on the fund's 2010 audited financial statements prepared and audited by the Auditing Firm. Total Wealth funneled the revenue sharing fees through the Side Entities, companies that apparently were created just for that purpose. Invoices were created to give the appearance that the fees were just payments for consulting work, even though no consulting work was ever done. The professionals who inquired about the revenue sharing agreements or asked for information about them either were not hired or were fired. This entire course of conduct by Total Wealth and Cooper was inherently deceptive, and had the principal purpose and effect of facilitating a scheme to conceal the revenue sharing fees while inducing investors to place their money in the Altus Capital Fund.

54. McNamee and Shoemaker aided and abetted Total Wealth and Cooper's fraudulent scheme. McNamee and Shoemaker created and submitted the false invoices to collect the revenue sharing fees, which gave the false appearance that the fees were for consulting when, in fact, they were for revenue sharing arrangements that had not been disclosed. Moreover, these fees were paid to entities that McNamee and Shoemaker apparently created solely for that purpose. Also, McNamee and Shoemaker substantially assisted in the scheme because each knew about the revenue sharing agreements and reviewed the materials provided to Total Wealth clients, but failed to make sure that these arrangements were sufficiently disclosed.

3. Total Wealth's Due Diligence Efforts

55. Total Wealth and Cooper also misled Altus investors about the due diligence they conducted on the holdings in the Altus Funds. Cooper is responsible for selecting the investments recommended by Total Wealth and held by the Altus Funds, and he identifies those investments mainly through word of mouth.

56. In face-to-face meetings and emails with potential investors, Cooper represented that he conducted "rigorous due diligence" to choose investments. The offering memoranda and the promotional materials for the Altus Capital Fund represented that the "leadership team . . . conduct[ed] regular reviews of all Fund investments including on-site manager visits and in-depth qualitative and quantitative due diligence." This representation

appeared in the executive summary provided to prospective investors and on the glossy folder that contained the prospective investor packet.

57. Such “in-depth qualitative and quantitative due diligence” was important to investors because Total Wealth and its investment adviser representatives were the clients’ only potential source of any information about the holdings in the Altus Funds. Moreover, as both the offering memoranda and the subscription agreement acknowledged, the profitability of the fund depended upon the abilities of Altus Management and Total Wealth to assess the future course of price movement of securities and to choose private investment funds.

58. Total Wealth’s and Cooper’s representations about due diligence are false. They did not conduct the due diligence they represented to investors. For many, if not all, of the investments held by the Altus Funds, Total Wealth did not perform any quantitative analysis of the investments. Total Wealth received promotional materials, subscription agreements, and the self-reported and unverified performance history of the underlying funds. However, Total Wealth failed to review or analyze such documents or obtain any third-party analysis of the underlying funds.

59. Moreover, Total Wealth did not have audited financial statements for many of the private funds held by the Altus Capital Fund. Even when Total Wealth did obtain audited financials, it either did not review them or did not obtain them for all the relevant periods before it invested client funds. Cooper relied on the underlying fund for almost all of his information about the fund.

60. Indeed, as early as 2010, Total Wealth knew at least two of the funds held in the Altus Capital Fund had financial issues. But this did not dissuade Total Wealth from continuing to place clients in the Altus Capital Fund or to hold the troubled funds in the Altus Capital Fund. The audited financial statements for one of these funds revealed that it had expenses (consisting almost exclusively of management fees, commissions, and incentive fees) of over \$700,000, but income of only \$5,000 – and that the only assets of this fund were cash and T-bills. In another fund, Cooper knew, prior to investing, that the fund generated investor returns by “borrowing the carry,” *i.e.*, paying interest to investors from the capital it raised from other investors. Nonetheless, the Altus Capital Fund invested with this fund. The company’s 2010 audited financial statements, prepared in 2012, showed that it was insolvent. The Altus Capital Fund is still invested with both of the funds described here.

61. Total Wealth and Cooper breached their fiduciary duties by failing to conduct the due diligence they claimed they were doing and making misrepresentations about the due diligence they performed.

4. Total Wealth’s Custody Rule Violation

62. As the managing member of Altus Management, which is the general partner of the Altus Funds, Total Wealth has custody of the funds and securities of its clients, the Altus funds, as well the funds and securities of the investors in those funds who are Total Wealth clients. As such, Total Wealth is required to comply directly with all the requirements of the Custody Rule, 17 C.F.R. §275.206(4)-2, unless it satisfied the requirements of the audit

exception, in which case it does not have to comply with Rule 206(4)-(2)(a)(2) (notice to clients) or (a)(3) (account statements to clients) and “will be deemed to have complied” with (a)(4) (independent verification by annual examination). Total Wealth neither complied with the provisions of Rule 206(4)-(2)(a)(4), nor did it satisfy this provision by taking the audit approach provided in 206(4)-2(b)(4), that is by having the Altus Funds audited annually by an independent public accountant who is registered with, and subject to regular inspection by, the PCAOB and by distributing audited financial statements prepared in accordance with GAAP to the Altus investors within 120 days of the end of its fiscal year. 17 C.F.R. §275. 206(4)-2(b)(4)(ii) (audit must be conducted “by an independent public accountant that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by the Public Company Accounting Oversight Board in accordance with its rules”) (emphasis added).

63. In its ADV filings since March 2011, Total Wealth has claimed that it has complied with the Custody Rule by having the Altus Funds audited annually by the Auditing Firm. Total Wealth also identifies the Auditing Firm as the auditor of the Altus Portfolio Series Funds in the offering memoranda for the funds in this series.

64. These representations are not true. The only audit that the Auditing Firm performed was of the 2010 financial statements of the Altus Capital Fund. But the Auditing Firm was not independent of the Altus Capital Fund as required by Regulation S-X because the Auditing Firm had prepared the 2010 financial statements for the Altus Capital Fund prior to conducting his audit. The Auditing Firm also was not subject to regular inspection by the PCAOB. Thus, Total Wealth could not use that audit to avail itself of the audit exception to the Custody Rule.

65. Cooper and McNamee aided and abetted Total Wealth’s Custody Rule violation. Both were the Auditing Firm’s principal contacts at Total Wealth during the Auditing Firm’s preparation of the 2010 financial statements and the Auditing Firm’s audit of those statements. Each knew or was reckless in not knowing that the Auditing Firm was required to be subject to regular inspection by the PCAOB if the Auditing Firm’s audits were to be used to satisfy the audit exception to the Custody Rule. As a result, both Cooper and McNamee knew, or were reckless in not knowing, that the Auditing Firm was not conducting annual audits as required by the rule, did not possess the requisite independence, and was not subject to regular PCAOB inspection as required by the Custody Rule. They also provided the Auditing Firm with information that the Auditing Firm used to prepare the Altus Fund financial statements, and reviewed those financial statements. Cooper also signed the management representation letter. Thus, Cooper and McNamee provided substantial assistance to Total Wealth’s Custody Rule violations.

E. VIOLATIONS

66. As a result of the conduct described above, Total Wealth, Cooper, McNamee and Shoemaker willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities by:

a. as to each Respondent, engaging in a scheme to defraud investors by directing client money to funds that paid revenue sharing fees and by collecting, and concealing their receipt of, revenue sharing fees in violation of Sections 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c);

b. as to McNamee and Shoemaker, obtaining money or property by means of material misstatements and omissions regarding the revenue sharing fees that each received in violation of Section 17(a)(2) of the Securities Act; and

c. as to Total Wealth and Cooper, making, and obtaining money or property by means of, material misrepresentations and omissions regarding their receipt of revenue sharing fees and the amount of due diligence they performed regarding the investments held by the Altus Funds in violation of Section 17(a)(2) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(b).

67. As a result of the conduct described above, McNamee and Shoemaker willfully aided and abetted and caused Total Wealth and Cooper's violations of Section 10(b) of the Exchange Act and Rule 10b-5(b).

68. In the alternative, as a result of the conduct described above, Cooper willfully aided and abetted and caused Total Wealth's violations of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

69. As a result of the conduct described above, Total Wealth and Cooper willfully violated Sections 206(1), 206(2), 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8, promulgated thereunder, by directing client money to funds that paid revenue sharing fees, without adequate disclosure, by engaging in a scheme to collect and conceal their receipt of the revenue sharing fees, and by otherwise misleading clients regarding these fees and their due diligence efforts, each of which breached their respective fiduciary duties in violation of 206(1), 206(2), 206(4) of the Advisers Act and Rule 206(4)-8;

70. As a result of the conduct described above, by failing to obtain independent verification of client funds and securities as set forth in Rule 206(4)-(2)(a), Total Wealth willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2, promulgated thereunder, which makes it a fraudulent, deceptive or manipulative act under Section 206(4) for any registered investment adviser to have custody of clients' funds or securities in a pooled investment vehicle unless that investment adviser complies with Rule 206(4)-2(a) or with the exceptions set forth in Rule 206(4)-2(b).

71. As a result of the conduct described above, by making misleading and false statements regarding the revenue sharing fees, Total Wealth's custody of client funds, the independence of the Altus Funds' auditor, and the annual audits of the Altus Funds, Total Wealth, Cooper, McNamee, and Shoemaker willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

72. As a result of the conduct described above, McNamee and Shoemaker willfully aided and abetted and caused Total Wealth and Cooper's violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8.

73. As a result of the conduct described above, Cooper and McNamee willfully aided and abetted and caused Total Wealth's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Total Wealth pursuant to Section 203(e) of the Advisers Act including, but not limited to, civil penalties and disgorgement pursuant to Sections 203(i) and (j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Cooper, McNamee and Shoemaker pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties and disgorgement pursuant to Section 203(i) and (j) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties and disgorgement pursuant to Section 9(d) and (e) of the Investment Company Act;

E. What, if any remedial action is appropriate in the public interest against McNamee pursuant to Section 15(b)(6) of the Exchange Act, including, but not limited to, civil penalties and disgorgement pursuant to Section 21B of the Exchange Act;

F. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Total Wealth should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-2 and 206(4)-8 thereunder; whether Total Wealth should be ordered to pay civil penalties pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Total Wealth should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Sections 203(j) and 203(k)(5) of the Advisers Act, and Section 9(e) of the Investment Company Act.

G. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Cooper should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-8 thereunder; whether Cooper should be ordered to pay civil penalties pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Cooper should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Sections 203(j) and 203(k)(5) of the Advisers Act, and Section 9(e) of the Investment Company Act.

H. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, McNamee should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-2 and 206(4)-8 thereunder; whether McNamee should be ordered to pay civil penalties pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether McNamee should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Sections 203(j) and 203(k)(5) of the Advisers Act, and Section 9(e) of the Investment Company Act.

I. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Shoemaker should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-8 thereunder; whether Shoemaker should be ordered to pay civil penalties pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Shoemaker should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Sections 203(j) and 203(k)(5) of the Advisers Act, and Section 9(e) of the Investment Company Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

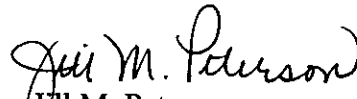

Jill M. Peterson
Assistant Secretary

Exhibit A

Table of Total Wealth False Forms ADV

Total Wealth Management, Inc. False Forms ADV

3/28/2011 ADV Annual Amendment 533094 New Brochure ID 41815, v. 1	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	Cooper
	Item 8(B)(3)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. <i>Does not disclose revenue sharing agreements.</i>	Cooper
	Item 9(A) and 9(C)	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that a related person has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicle (Altus Fund) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicle annually.</i>	Cooper
New Brochure ID 41815, v.1	Part 2A: Item 4(B), Item 5(C), Item 10(C)	Total Wealth <i>may</i> have arrangements with certain Independent Managers whereby Total Wealth or one of its associated persons receives a percentage of the fees charged by such Independent Managers (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such</i>	n/a

		<i>arrangements.</i>	
	Part 2A: Item 10(A)	Cooper owns an unregistered consulting firm, and Total Wealth <i>may</i> incorporate some of the financial products or securities offered by clients of the consulting firm in its clients' portfolios (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	n/a
	Part 2A: Item 15	Total Wealth has custody of client funds because it has authority to debit its fees directly from the client's account and it "may also be deemed" to have custody because it has a related person that serves as a general partner to a limited partnership. Total Wealth "will be deemed" to have complied with the Custody Rule because the Altus funds are subject to annual audit by an independent public accountant subject to regular inspection by the PCAOB, and each fund's audited financial statements are prepared in accordance with generally accepted accounting principles and are distributed to all limited partners within 180 days of the end of the fiscal year. <i>Ogbomo is not independent, he is not subject to regular inspection by the PCAOB, and he does not audit the pooled investment vehicle annually.</i>	n/a
8/23/2011 Other Than Annual Amendment 57774 Amended	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	Cooper

Brochure ID 41815, v.2			
	Item 8(B)(3)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. <i>Does not disclose revenue sharing agreements.</i>	Cooper
	Item 9(A) and 9(C)	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that a related person has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicle (Altus Fund) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicle annually.</i>	Cooper
Amended Brochure ID 41815, v.2	Part 2A: Item 4(B), Item 5(C), Item 10(C)	Total Wealth <i>may</i> have arrangements with certain Independent Managers whereby Total Wealth or one of its associated persons receives a percentage of the fees charged by such Independent Managers (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	n/a
	Part 2A: Item 10(A)	Cooper owns an unregistered consulting firm, and Total Wealth <i>may</i> incorporate some of the financial products or securities offered by clients of the consulting firm in its clients' portfolios (emphasis added). <i>Does not disclose that such arrangements</i>	n/a

		<i>actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	
	Part 2A: Item 15	Total Wealth has custody of client funds because it has authority to debit its fees directly from the client's account and it "may also be deemed" to have custody because it has a related person that serves as a general partner to a limited partnership. Total Wealth "will be deemed" to have complied with the Custody Rule because the Altus funds are subject to annual audit by an independent public accountant subject to regular inspection by the PCAOB, and each fund's audited financial statements are prepared in accordance with generally accepted accounting principles and are distributed to all limited partners within 180 days of the end of the fiscal year. <i>Ogbomo is not independent, he is not subject to regular inspection by the PCAOB, and he does not audit the pooled investment vehicle annually.</i>	n/a
4/2/2012 ADV Annual Amendment 636575 Amended Brochure ID 41815, v.3	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 7, Section 7.B.(1) (Private Fund Reporting)	Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series), that the financial statements are prepared in accordance with GAAP, and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he</i>	McNamee

		<i>does not audit the pooled investment vehicles annually.</i>	
	Item 8(B)(3) and 8(I)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. Claims not to receive, directly or indirectly, compensation from any person for client referrals. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 9(A) and 9(C), Schedule D	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that a related person has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i> Claims that the independent public accountant is subject to regular inspection by the PCAOB. <i>Ogbomo is not subject to regular inspection.</i>	McNamee
Amended Brochure ID 41815, v.3	Part 2A: Item 4(B), Item 5(C), Item 10(C)	Total Wealth <i>may</i> have arrangements with certain Independent Managers whereby Total Wealth or one of its associated persons receives a percentage of the fees charged by such Independent Managers (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	n/a

	Part 2A: Item 10(A)	Cooper owns an unregistered consulting firm, and Total Wealth <i>may</i> incorporate some of the financial products or securities offered by clients of the consulting firm in its clients' portfolios (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	n/a
	Part 2A: Item 15	Total Wealth has custody of client funds because it has authority to debit its fees directly from the client's account and it "may also be deemed" to have custody because it has a related person that serves as a general partner to a limited partnership. Total Wealth "will be deemed" to have complied with the Custody Rule because the Altus funds are subject to annual audit by an independent public accountant subject to regular inspection by the PCAOB, and each fund's audited financial statements are prepared in accordance with generally accepted accounting principles and are distributed to all limited partners within 180 days of the end of the fiscal year. <i>Ogbomo is not independent, he is not subject to regular inspection by the PCAOB, and he does not audit the pooled investment vehicle annually.</i>	n/a
2/26/2013 Other than Annual Amendment 680211	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 7, Section 7.B.(1)	Claims that an independent public accountant audits annually the pooled	McNamee

		investment vehicles (Altus Fund, Altus Portfolio Series), that the financial statements are prepared in accordance with GAAP, and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i>	
	Item 8(B)(3) and 8(I)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. Claims not to receive, directly or indirectly, compensation from any person for client referrals. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 9(A) and 9(C), Schedule D	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that related party has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i> Claims that the independent public accountant is subject to regular inspection by the PCAOB. <i>Ogbomo is not subject to regular inspection.</i>	McNamee
2/26/2013 Other than Annual	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose</i>	McNamee

Amendment 705676		revenue sharing agreements.	
	Item 7, Section 7.B.(1)	Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series), that the financial statements are prepared in accordance with GAAP, and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i>	McNamee
	Item 8(B)(3) and 8(I)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. Claims not to receive, directly or indirectly, compensation from any person for client referrals. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 9(A) and 9(C), Schedule D	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that related party has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i> Claims that the independent public accountant is subject to regular inspection by the PCAOB. <i>Ogbomo is not subject to regular inspection.</i>	McNamee

4/5/2013 Annual Amendment 723934 New Brochure ID 99040, v.1	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 7, Section 7.B.(1)	Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series), that the financial statements are prepared in accordance with GAAP, and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i>	McNamee
	Item 8(B)(3) and 8(I)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. Claims not to receive, directly or indirectly, compensation from any person for client referrals. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 9(A) and 9(C), Schedule D	Claims that Total Wealth does not have custody of any advisory clients' accounts. Does disclose that related party has custody. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled</i>	McNamee

		<i>investment vehicles annually.</i> Claims that the independent public accountant is subject to regular inspection by the PCAOB. <i>Ogbomo is not subject to regular inspection.</i>	
New Brochure ID 99040, v.1	Part 2A: Item 4(B), Item 5(C), Item 10(C)	Total Wealth <i>may</i> have arrangements with certain Independent Managers whereby Total Wealth or one of its associated persons receives a percentage of the fees charged by such Independent Managers (emphasis added). <i>Does not disclose that such arrangements actually exist, or that the Altus Fund places a majority of its funds with managers that have such arrangements.</i>	n/a
	Part 2A: Item 10(A)	<i>Does not disclose that Cooper owns an unregistered consulting firm, or that the Altus Fund places funds with managers that have arrangements with the consulting firm.</i>	n/a
	Part 2A: Item 15	Total Wealth has custody of client funds because it has authority to debit its fees directly from the client's account and it "may also be deemed" to have custody because it has a related person that serves as a general partner to a limited partnership. Total Wealth "will be deemed" to have complied with the Custody Rule because the Altus funds are subject to annual audit by an independent public accountant subject to regular inspection by the PCAOB, and each fund's audited financial statements are prepared in accordance with generally accepted accounting principles and are distributed to all limited partners within 180 days of the end of the fiscal year. <i>Ogbomo is not independent, he is not subject to regular inspection by the PCAOB, and he does not audit the</i>	n/a

		<i>pooled investment vehicle annually.</i>	
5/22/2013 Other than Annual Amendment 738879	Item 5(E)	Claims to be compensated only by (1) percentage of assets under management; (2) hourly charges; and (3) fixed fees. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 7, Section 7.B.(1)	Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series), that the financial statements are prepared in accordance with GAAP, and the audited financial statements are delivered to investors. <i>Claims that the report contains an unqualified opinion. Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i>	McNamee
	Item 8(B)(3) and 8(I)	Claims not to recommend the purchase or sale of any securities to advisory clients for which Total Wealth or any related person has any other sales interest. Does disclose that related party has custody. <i>Does not disclose revenue sharing agreements.</i>	McNamee
	Item 9(A) and 9(C), Schedule D	Claims that Total Wealth does not have custody of any advisory clients' accounts. <i>Total Wealth is the managing member of Altus Management, which is the general partner of the Altus Fund limited partnership.</i> Claims that an independent public accountant audits annually the pooled investment vehicles (Altus Fund, Altus Portfolio Series) and the audited financial statements are delivered to investors. <i>Ogbomo is not independent, and he does not audit the pooled investment vehicles annually.</i>	McNamee

		Claims that the independent public accountant is subject to regular inspection by the PCAOB. <i>Ogbomo is not subject to regular inspection.</i>	
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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71947 / April 15, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15841

In the Matter of

**Amcore Financial, Inc.,
China Sure Water (USA), Inc.,
EuroBancshares, Inc.,
InterAmerican Acquisition Group, Inc.,
Link Scaffold Products North America,
Stone Tan China Acquisition Corp., and
Vanholt Group, Ltd.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Amcore Financial, Inc., China Sure Water (USA), Inc., EuroBancshares, Inc., InterAmerican Acquisition Group, Inc., Link Scaffold Products North America, Stone Tan China Acquisition Corp., and Vanholt Group, Ltd. (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Amcore Financial, Inc. (CIK No. 714756) is a revoked Nevada corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Amcore Financial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2009, which reported a net loss of \$233,783 for

the prior twelve months. On August 19, 2010, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Illinois, and the case was terminated on June 4, 2012.

2. China Sure Water (USA), Inc. (CIK No. 1510256) is a New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Sure Water is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011.

3. EuroBancshares, Inc. (CIK No. 1164554) is a Puerto Rico corporation located in San Juan, Puerto Rico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EuroBancshares is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of over \$15.9 million for the prior nine months. As of February 4, 2014, the company's stock (symbol "EUBK") was traded on the over-the-counter markets.

4. InterAmerican Acquisition Group, Inc. (CIK No. 1328494) is a merged out Delaware corporation located in Indianapolis, Indiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). InterAmerican is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of \$207,329 for the prior six months.

5. Link Scaffold Products North America (CIK No. 1447873) is a revoked Nevada corporation located in Edmonton, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Link Scaffold is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended March 31, 2010, which reported a net loss of \$8,957 for the prior twelve months.

6. Stone Tan China Acquisition Corp. (CIK No. 1390332) is a forfeited Delaware corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stone Tan China is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of \$622,297 for the prior six months.

7. Vanholt Group, Ltd. (CIK No. 1435622) is a void Delaware corporation located in Cincinnati, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Vanholt is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$3,000 for the prior three months.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71949 / April 15, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15843

In the Matter of

ROBERT C. RICE,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Robert C. Rice ("Rice" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Rice, age 50, is a resident of Tallahassee, Florida. In the civil action entitled Securities and Exchange Commission v. K2 Unlimited, Inc., et al., Civil Action Number 1:11-cv-11649, in the United States District Court for the District of Massachusetts, the Commission alleged that Rice offered clients of K2 Unlimited, Inc. and 211 Ventures, LLC securities without being registered as a broker or dealer in accordance with Section 15(b) of the Exchange Act [15 U.S.C. § 78o(b)].

2. On April 4, 2014, a final judgment was entered by consent against Rice, permanently enjoining him from future violations of Sections 5(a) and (c) and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. K2 Unlimited, Inc., et al., Civil Action Number 1:11-cv-11649, in the United States District Court for the District of Massachusetts.

3. The Commission's complaint alleged that Rice, through K2 Unlimited, Inc., and through 211 Ventures, LLC, purported to offer venture capital financing to clients by the use of fictitious instruments called bank guarantees, and also offered clients direct investments in fraudulent and non-existent trading programs, promising high returns and guarantees against loss. The Commission alleged that Rice, with others, defrauded investors of at least \$1.8 million by offering these fictitious investments.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Rice's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Rice be, and hereby is:

Barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served

as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71951 / April 15, 2014

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3550 / April 15, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-13737

	:	ORDER GRANTING APPLICATION FOR
In the Matter of	:	REINSTATEMENT TO APPEAR AND PRACTICE
	:	BEFORE THE COMMISSION AS AN ACCOUNTANT
Scott T. Veech, CPA	:	RESPONSIBLE FOR THE PREPARATION OR
	:	REVIEW OF FINANCIAL STATEMENTS REQUIRED
	:	TO BE FILED WITH THE COMMISSION

On January 6, 2010, Scott T. Veech, CPA ("Veech") was suspended from appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against Veech pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹ This order is issued in response to Veech's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission found that Veech participated in a fraudulent scheme which resulted in Merge Healthcare Inc. ("Merge") filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal years ended December 31, 2002, December 31, 2003 and December 31, 2004, and in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal year 2005. While serving as Merge's Chief Financial Officer, Veech engaged in improper accounting practices that materially increased the company's annual and quarterly revenue in a material departure from generally accepted accounting principles. These practices included, among other things, causing Merge to recognize revenue improperly on transactions in which Merge promised specified future software enhancements to customers. As a result, Veech violated Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 13(b)(5) of the Securities Exchange Act ("Exchange Act") and Rules 10b-5, 13a-14, 13b2-1 and 13b2-2 thereunder, and he aided and abetted violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

¹ See Accounting and Auditing Enforcement Release No. 3096 dated January 6, 2010. Veech was permitted, pursuant to the order, to apply for reinstatement after three years upon making certain showings.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review of financial statements of a public company to be filed with the Commission, Veech attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Veech is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to appear and practice before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Veech's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."² This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Veech, it appears that he has complied with the terms of the January 6, 2010 order suspending him from appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Veech, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Scott T. Veech, CPA is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.


Jill M. Peterson
Assistant Secretary

² Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71945; File No. SR-NSCC-2014-802)

April 15, 2014

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Enhance NSCC's Existing Parametric Value-at-Risk Margining Model

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")¹ and Rule 19b-4(n)(1)(i)² thereunder, notice is hereby given that on March 28, 2014, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-NSCC-2014-802 ("Advance Notice") as described in Item I, II and III below, which Items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

The Advance Notice is filed by NSCC in connection with a proposed adjustment to NSCC's existing parametric Value-at-Risk ("VaR") margining model, as more fully described below.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the Advance Notice and discussed any comments it received on the Advance Notice. The text of these statements may be examined at the places specified in Item IV below.

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(i).

NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

1. Purpose

In connection with its on-going assessment of the performance of its margining models, NSCC is proposing to enhance its existing parametric VaR model by supplementing the assumption of normal distribution underlying the current model with a family of Student's t-distributions. Currently, NSCC's parametric VaR methodology is based on the assumption that the underlying securities portfolio return distribution is normal. In an effort to enhance its parametric VaR model, NSCC has reviewed prevalent academic research and data analyses which show that the empirical distributions of securities portfolio returns in the equities markets have "fatter tails" than what the normal distribution implies, and VaR margin computed based only on the normality assumption may underestimate the tail risk that is observed during market volatility ("fat-tail" risk).

NSCC has evaluated a number of possible approaches to enhance its parametric VaR model in order to better accommodate fat-tail risks, and is proposing to apply an approach that is most appropriate for NSCC and its circumstances. As such, the proposed enhancement would utilize NSCC's existing parametric VaR model, and would supplement the normal distribution underlying the model with a factor that utilizes the degrees of freedom ("DOF") derived from a family of Student's t-distributions. The factor will help adjust the normal-based VaR model to better reflect the distribution of actual observed historical returns. Further, the existing normal distribution in the parametric VaR model will operate as a floor to the proposed adjustments.

2. Statutory Basis

The proposed change is being filed pursuant to Section 806(e)(1) of the Clearing Supervision Act, and is consistent with Rule 17Ad-22(b)(2), promulgated thereunder, which requires a registered clearing agency to “use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements.”³ Specifically, the adjustment is expected to allow NSCC’s parametric VaR model to remain above its 99% coverage target during market volatility, and to more appropriately calculate and collect margin, which better enables NSCC to respond in the event that a Member defaults and minimizes potential losses to NSCC and its non-defaulting Members. As such, NSCC believes that the proposal promotes robust risk management and the safety and soundness of NSCC’s operations, which reduce systemic risk and support the stability of the broader financial system, consistent with the requirements of Rule 17Ad-22(b)(2), cited above.

(B) Clearing Agency’s Statement on Comments on the Advance Notice Received from Members, Participants, or Others

In November 2013, NSCC distributed a White Paper to its Members that described the proposed enhancement to the parametric VaR model and the results of an impact study showing the potential impact of this proposal on Members’ Clearing Fund required deposits. NSCC did not receive any written comments relating to the enhancement to the parametric VaR model in response to this White Paper. NSCC will notify the Commission of any written comments received by NSCC.

(C) Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

1. Description of Change

³ 17 CFR 240.17Ad-22(b)(2).

(i) Overview

A primary objective of NSCC's Clearing Fund is to have on deposit from each applicable Member assets sufficient to satisfy losses that may otherwise be incurred by NSCC as the result of the default of the Member and the resultant close out of that Member's unsettled positions under NSCC's trade guaranty. Each Member's Clearing Fund required deposit is calculated daily pursuant to a formula set forth in Procedure XV of the NSCC's Rules and Procedures ("Rules") designed to provide sufficient funds to cover this risk of loss. The Clearing Fund formula accounts for a variety of risk factors through the application of a number of components, each described in Procedure XV. The VaR component is a core component of this formula and is designed to calculate the amount of money that may be lost on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a given level of confidence.

Parametric VaR models utilized in the equities markets have historically computed risk on the assumption that the underlying securities portfolio return distribution is normal. The increased frequency of market volatility in recent years has stressed the performance of parametric VaR models throughout the financial services industry. Analyses of these events and VaR models have shown that "fat-tail" risk may not be properly addressed by parametric VaR models that are based only on the normal distribution assumption. As such, it has become market practice to move away from the use of normal distribution assumptions in parametric VaR models and to instead use distributions, such as Student's t-distributions, that better accommodate these fat-tail risk events.

NSCC conducts back tests to measure the performance of Members' portfolios against the calculated VaR margin requirements for those portfolios. Over the past few years, these back tests have shown that, while NSCC's VaR margin component has remained mostly above its

99% coverage target when tested over a longer time horizon (a 12-month rolling window), coverage fell below the 99% target in a few instances in which back tests were conducted over shorter time frames (1-month windows). Therefore, and in connection with its on-going assessment of the performance of its margining models, NSCC has evaluated various possible approaches to enhance its parametric VaR model, and is proposing to apply an approach that incorporates Student's t-distributions into that model in a way that is appropriate for NSCC and its circumstances.

The proposal would enhance NSCC's existing parametric VaR model, which is used as part of the calculation of the VaR component, by supplementing the assumption of normal distribution underlying the current model with a factor that utilizes the DOF derived from a family of Student's t-distributions. The proposal is expected to improve NSCC's back-testing performance over shorter time horizons, particularly during more volatile market environments, and should enable the model to better account for the higher degree of fat-tail risk observed in equities markets.

(ii) Adjustment to Existing Parametric VaR Model

The proposed enhancement would utilize NSCC's current parametric VaR model, and would supplement the current normal distribution underlying the parametric VaR model with a factor that utilizes the DOF derived from a family of Student's t-distributions, which are more representative of the historically observed distributions in the equities markets. The Student's t-distributions would introduce an additional statistical parameter, the DOF factor, to the model. Following this enhancement, NSCC would estimate the DOF factor of the empirical t-distribution in the model periodically by using daily return data from the S&P 500 over a historical window no shorter than 12-months. NSCC would then compute a multiplication factor

that represents the magnitude of increase of t-distribution-based parametric VaR from the normal-based parametric VaR. This multiplication factor would be applied to Members' VaR margin requirement.

NSCC has considered various alternatives to enhance its parametric VaR model, and its internal studies have shown that this proposed enhancement is an appropriate approach to addressing tail risks at NSCC, and may be a more effective enhancement to the model than other possible adjustments, including the augmented volatility model (AVM), which NSCC has also considered. In 2012, NSCC designed AVM to protect NSCC from elevated levels of volatility that were not captured in historical data by incorporating the CBOE VIX, a forward-looking measure of volatility, into the model. While both this proposal and AVM would improve NSCC's ability to meet its back-testing coverage target, the proposed enhancement to NSCC's parametric VaR model described in this filing is expected to be a more stable adjustment to Members' VaR margin components than AVM, while still improving the model's back-test performances.

2. Anticipated Effect on and Management of Risks

NSCC believes that the proposed enhancement to its current parametric VaR model would improve NSCC's risk management by enabling the model to remain above its 99% coverage target during market volatility, and to more appropriately calculate and collect margin, which better enables NSCC to respond in the event that a Member defaults. Further, incorporation of the DOF factor into NSCC's existing parametric VaR model should more accurately capture the fat-tail characteristics of stock market return distributions.

Additionally, NSCC has conducted extended outreach with its Members regarding the proposed enhancement, describing the proposed change, the reasoning for the change, and the

potential impact of the change – both the expected impact on Members' Clearing Fund required deposits as well as the improvement to NSCC's risk management. This outreach included the publication of a White Paper to impacted Members in November 2013 as well as individual outreach to Members to discuss the results of impact studies. The proposed enhancement is expected to have a relatively low impact on Members' VaR margin components and thus a minimal impact on Members' overall Clearing Fund required deposits. NSCC did not receive any objections to the proposed change from Members in response to this outreach.

NSCC believes that the proposed change should allow it to collect margin that covers to a greater degree of certainty the risk that it may face during market volatility or even extreme market environments. While this change would impact NSCC's Members' Clearing Fund requirements, as stated above, NSCC's Members are aware of the proposed change and the potential impact on their Clearing Fund required deposits. Further, prior to implementation of the proposed changes, NSCC will run a parallel period during which Members would be able to further review the possible impact.

III. Date of Effectiveness of the Advance Notice, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. NSCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission or the Board of Governors of the Federal Reserve System providing NSCC with prompt written notice of the

extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies NSCC in writing that it does not object to the proposed change and authorizes NSCC to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

NSCC shall post notice on its website of proposed changes that are implemented.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the Advance Notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-NSCC-2014-802 on the subject line.

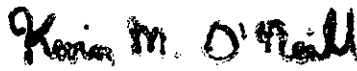
Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-NSCC-2014-802. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to

the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on NSCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-NSCC-2014-802 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.



Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71955 / April 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15844

In the Matter of

KENNETH C. TEBBS,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b)(6) OF THE SECURITIES EXCHANGE
ACT OF 1934 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Kenneth C. Tebbs ("Respondent" or "Tebbs").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent was the primary owner and manager of Twin Peaks Financial, Inc. and MNK Investments, Inc. From September 2000 until February 2006, a portion of the time in which Tebbs engaged in the conduct underlying the felony information described below, Respondent was also a registered representative associated with Farmers Financial Solutions, LLC, a registered broker-dealer. Respondent, 42 years old, was a resident of Riverton, Utah and is currently incarcerated in Lompoc federal penitentiary in Lompoc, California.

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B. ENTRY OF THE INJUNCTION/RESPONDENT'S CRIMINAL CONVICTION

2. On February 11, 2013, Tebbs pleaded guilty to one count of wire fraud in violation of 18 U.S.C. § 1343, United States v. Kenneth Case Tebbs, felony information No. 2:12-cr-00672-DS, (D. Utah). On September 16, 2013, Tebbs was convicted of one count of wire fraud in violation of 18 U.S.C. § 1343 and was sentenced to 78 months imprisonment, 3 year probation and restitution of \$12,583,599.

3. The count of the felony information to which Tebbs pleaded guilty alleged, inter alia, that Tebbs, in connection with the offer or sale of securities to investors, knowingly devised a plan to obtain money from investors by means of pretenses, representations, and omissions of material fact which he knew were false and misleading.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b)(6) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Petersen
Assistant Secretary

Kevin M. O'Neill
By: **Kevin M. O'Neill**
Deputy Secretary

*Commissioner Rowan
Not participating*

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 71970 / April 17, 2014

Admin. Proc. File No. 3-15183

In the Matter of the Application of

GREGORY EVAN GOLDSTEIN
c/o Martin P. Unger
Wexler Burkhardt Hirschberg & Unger, LLP
377 Oak Street, Concourse Level C2
Garden City, NY 11530

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY
PROCEEDINGS

Failure to Provide Requested Information

Associated person, officer, and control person of member firm failed to fully respond to FINRA's requests for information and documents of such person made pursuant to FINRA Rule 8210. *Held*, association's findings of violation and imposition of sanctions are sustained, except the fine it imposed is set aside.

APPEARANCES:

Martin P. Unger, of Wexler Burkhardt Hirschberg & Unger, LLP, for Gregory Evan Goldstein.

Robert L.D. Colby, Alan Lawhead, and Carla Carloni, for FINRA.

Appeal filed: January 22, 2013
Last brief received: May 29, 2013

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Gregory Evan Goldstein, formerly an associated person, president, and control person of Marquis Financial Services, Inc. ("Marquis"), a FINRA member firm, seeks review of a disciplinary action taken against him by FINRA. FINRA found that Goldstein violated FINRA Rule 8210 by refusing to answer questions at an on-the-record interview ("OTR") and by failing to produce information and documents requested by FINRA about Wall Street at Home, Inc. ("Wall Street at Home"), a company that is eighty percent owned by Goldstein. Goldstein claims, among other things, that FINRA's requests went beyond the scope of Rule 8210. We disagree based on our independent review of the record, and we find that the requests were within the scope of Rule 8210 and sustain FINRA's findings of violation and imposition of sanctions, except that we set aside the fine imposed.

I. Background

A. Goldstein, Marquis, and Wall Street at Home

The parties do not dispute the relevant facts. Goldstein was registered with FINRA at Marquis from July 2001 through February 2013.¹ Marquis is ninety-five percent owned by the holding company Steven Gregory Securities ("SGS").² SGS is, in turn, wholly owned by Wall Street at Home. And Wall Street at Home is eighty percent owned by Goldstein. Goldstein is also the president of Marquis, SGS, and Wall Street at Home, and he is the sole officer and voting stockholder of Wall Street at Home.³

The remaining minority shares of Wall Street at Home were sold in a private offering in 2003 to approximately twenty to thirty investors, including customers of Marquis. Marquis served as the placement agent for the offering. Wall Street at Home, in its private placement memorandum, claimed to "operate a full service, retail securities brokerage business through [its] subsidiary, Marquis."

Wall Street at Home also has consulting clients. Goldstein provides all services to these clients, for which Wall Street at Home is paid directly by the clients. The consulting work includes the review of corporate structures and performance of due diligence to determine whether companies are viable.⁴ Goldstein, the only person with access to Wall Street at Home's funds, stipulated that he "takes distributions of funds" from Wall Street at Home for services he

¹ According to BrokerCheck, Goldstein either terminated or withdrew his registration with FINRA as of February 2013. We take official notice of this information on BrokerCheck, an electronic database maintained by FINRA and available at www.finra.org/Investors/Tools/Calculators/BrokerCheck. See 17 C.F.R. § 201.323 (rule of practice relating to official notice).

² SGS has no operations other than owning Marquis.

³ Neither SGS nor Wall Street at Home has ever had any employees.

⁴ Wall Street at Home was also paid in 2004 by Headliners Entertainment Group, Inc. for introducing potential investors to it. As discussed below, Goldstein has refused to describe the precise nature of his work for Wall Street at Home.

performs on its behalf. Goldstein also pays Wall Street at Home's bills and expenses, such as his traveling expenses, with the company's funds.

B. FINRA's investigation

FINRA began investigating Marquis and its employees, including Goldstein, in 2010 after receiving a referral from FINRA Member Regulation regarding suspicious trading in penny stocks at Marquis. FINRA's investigation into Marquis and Goldstein, which is ongoing, also concerns other potential securities law violations, including whether they engaged in selling away, buying away, spinning, front-running, market manipulation, fraud, and violation of the anti-money laundering ("AML") rules. FINRA is also investigating potential conflicts between Marquis and Goldstein on the one hand and the customers of Marquis on the other.

FINRA's Rule 8210 authorizes FINRA to require associated persons to provide information or documents in an investigation.⁵ Pursuant to this Rule, FINRA sent an initial Rule 8210 request to Goldstein with thirty-four enumerated requests for information and/or documents. The record does not reflect how Goldstein responded to this request, but we assume for purposes of this proceeding that he complied fully with it.⁶

FINRA subsequently conducted an OTR of Goldstein pursuant to Rule 8210 on January 9, 2012, during which Goldstein, who was represented by counsel, refused to answer certain questions about Wall Street at Home. Goldstein refused to identify Wall Street at Home's customers, or state which firm maintained Wall Street at Home's brokerage account. Goldstein's counsel asserted at the OTR that these questions about Wall Street at Home were beyond FINRA's authority.

Goldstein did answer other questions asked of him during the OTR concerning Wall Street at Home and other issues. But some of his responses demonstrated a lack of candor. When Goldstein was asked, for example, whether Wall Street at Home ever had an outside brokerage account, he responded, "I'm not sure" and "I can't recall."⁷ Goldstein's response lacked credibility considering that he was the president and sole officer of Wall Street at Home, and that Wall Street at Home had no employees.

FINRA sent a subsequent Rule 8210 request to Goldstein on February 3, 2012, in which it renewed its request for the information Goldstein refused to provide during the OTR and sought additional information and documents relating to Wall Street at Home. In particular, FINRA requested that Goldstein (i) identify Wall Street at Home's owners and customers;

⁵ See Rule 8210(a).

⁶ The record does not include a copy of this Rule 8210 request or Goldstein's response.

⁷ Wall Street at Home did in fact have a brokerage account. Goldstein also denied holding an outside brokerage account in his own name (i) in his 2010 and 2011 annual written attestations for Marquis and (ii) in an email to a FINRA examiner dated May 28, 2010. But Goldstein held an outside brokerage account at UBS Financial Services, Inc. from 2008 through 2011.

(ii) describe the products, services, or business activities provided by Wall Street at Home; (iii) produce documents, including contracts, service agreements, and payment terms, relating to Wall Street at Home's customers, and if no such documents exist, provide a summary of the compensation received from those customers; (iv) identify each person who initiated, reviewed, or authorized any financial transaction for Wall Street at Home; (v) identify Wall Street at Home's bank and brokerage accounts and produce the monthly statements for those accounts; and (vi) produce Wall Street at Home's tax returns and supporting documents. Goldstein refused to comply with FINRA's request, stating in a letter from counsel dated February 16, 2012, that FINRA has no "authority to require a member or an associated person to produce documents belonging to a third party, particularly those unrelated to the member and/or associated person[]"s securities activities (as here)."

On March 13, 2012, FINRA issued a Notice of Suspension informing Goldstein that he would be suspended, pursuant to FINRA Rule 9552(a), from association with any FINRA member firm in any capacity unless he complied with its Rule 8210 requests by April 6, 2012.⁸ In response, Goldstein requested an expedited hearing,⁹ and the parties subsequently agreed to a resolution of the matter on the basis of stipulated facts and legal briefs rather than an evidentiary hearing.

C. The FINRA proceeding below

In a decision dated January 4, 2013, a FINRA hearing panel found that Goldstein violated Rule 8210 by refusing to answer certain questions during the OTR or provide information and documents subsequently requested. The panel noted that the inquiries with which Goldstein refused to comply generally concern his outside business activities conducted through Wall Street at Home and that Goldstein owns, possesses, and controls the requested information. The panel also noted that "Goldstein's business activities through Wall Street at Home appear closely related to his conduct of a securities business through FINRA member firm Marquis."

The panel ordered Goldstein to comply fully with the outstanding Rule 8210 requests within twenty-one days of the date of the decision and ordered a three-month suspension from association with any member firm in any capacity if he failed to comply within that period. The panel further ordered that "if the suspension is not terminated within three months for full compliance, then [Goldstein] will be barred from associating with any member firm in any

⁸ FINRA Rule 9552(a) provides that, if an associated person fails to provide any information, material, or testimony requested pursuant to FINRA rules, FINRA may provide written notice specifying the nature of the failure and stating that a failure to take corrective action within twenty-one days after service of the notice will result in a suspension.

⁹ FINRA Rule 9552(e) provides that a person served with notice of a failure to provide requested information under Rule 9552(a) may file with the Office of Hearing Officers a written request for a hearing. A timely hearing request stays the suspension referenced in the notice unless the hearing officer orders otherwise. See Rule 9552(d); Rule 9559(c)(1).

capacity and fined \$50,000."¹⁰ Because FINRA's National Adjudicatory Council did not call the decision for review, the decision is the final action of FINRA in this proceeding.¹¹

Goldstein did not comply with FINRA's outstanding requests within the period set by the panel, so he became barred from association with any FINRA member firm in any capacity and fined \$50,000.¹²

II. Analysis of Violations

A. Standard of review

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.¹³ Pursuant to Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary sanction, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the SRO's rules, and whether such SRO rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.¹⁴

¹⁰ FINRA Rule 9552(f) provides for the termination of a suspension imposed pursuant to Rule 9552 upon full compliance with the notice of suspension or decision. If the suspension is not terminated within three months of the notice of suspension or decision, the suspension automatically becomes a bar pursuant to Rule 9552(h).

¹¹ The hearing panel submitted its proposed decision to the NAC in advance of January 4, 2013. When the NAC did not call the case for review within twenty-one days as provided in FINRA Rule 9559(q)(1), the hearing panel issued its decision on January 4, 2013, along with a Notice of Decision.

¹² We take official notice of this information on BrokerCheck (www.finra.org/Investors/Tools/Calculators/BrokerCheck).

¹³ See *David M. Levine*, Exchange Act Release No. 48760, 2003 SEC LEXIS 2678, at *36 n.42 (Nov. 7, 2003).

¹⁴ 15 U.S.C. § 78s(e)(1). We previously found that Rule 8210 "is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association." Exchange Act Release No. 68386, 2012 SEC LEXIS 3798, at *26 (Dec. 7, 2012) ("Rule 8210 Order"); see also Exchange Act Release No. 38908, 1997 SEC LEXIS 1617, at *111-18 (Aug. 7, 1997). In particular, we found Rule 8210 to be "consistent with Section 15A(b)(6) of the Exchange Act, which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of Trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest." Rule 8210 Order, 2012 SEC LEXIS 3798, at *26.

B. Goldstein violated Rule 8210.

Goldstein does not dispute that he failed to respond to certain Rule 8210 requests and that, as a person associated with a member firm, he was required to comply with Rule 8210.¹⁵ But Goldstein contends that he did not violate Rule 8210 because FINRA's requests were beyond the scope of the Rule.

Although the scope of Rule 8210 is broad, it is limited by its own language.¹⁶ Rule 8210(a)(1), prior to its amendment effective on February 25, 2013,¹⁷ stated in part that FINRA may, for the purpose of an investigation, "require a . . . person associated with a member . . . to provide information orally, in writing, or electronically . . . and to testify . . . *with respect to any matter involved in the investigation.*"¹⁸ Rule 8210(a)(2), prior to its amendment, stated in part that FINRA may, for the purpose of an investigation, "inspect and copy the books, records, and accounts of such . . . person [associated with a member] *with respect to any matter involved in the investigation.*"¹⁹ Under this language, requests under either subsection (a)(1) or (a)(2) of Rule 8210 must be "with respect to any matter involved in the investigation." In addition, requests under subsection (a)(2) of Rule 8210 must be "of such member or person" associated with a member.

The material requested from Goldstein fell squarely within the language of the Rule, even under a narrow interpretation of its scope. The information requested was "with respect to any matter involved in the investigation," notwithstanding Goldstein's contention that "the relevance to FINRA's investigation of the names of the 20-30 Wall Street [at Home] shareholders and . . . customers, the 'business services' provided by Wall Street [at Home] to its customers, the compensation Wall Street [at Home] received for the consulting services provided, Wall Street[] [at Home's] tax returns, and so on remains elusive." FINRA's Rule 8210 requests were with respect to matters involved in the investigation of Marquis and Goldstein, including the nature

¹⁵ See Rule 8210(a)(1) (requiring an associated person to provide information); Rule 8210(a)(2) (stating that FINRA may inspect and copy an associated person's books, records, and accounts). Under FINRA Rule 8210(c), it is a violation of the rule for an associated person to "fail to provide information or testimony or to permit an inspection and copying of books, records, or accounts."

¹⁶ *Jay Alan Ochanpaugh*, Exchange Act Release No. 54363, 2006 SEC LEXIS 1926, at *13 (Aug. 25, 2006).

¹⁷ In December 2012, we approved FINRA's proposed amendments to Rule 8210, which became effective on February 25, 2013. Rule 8210 Order, 2012 SEC LEXIS 3798; *see also* FINRA Regulatory Notice 13-06, 2013 FINRA LEXIS 8 (Jan. 2013) (providing notice that the Commission approved FINRA's proposed amendments to Rule 8210). But FINRA applied and we are applying the version of Rule 8210 that existed at the time of the conduct at issue here.

¹⁸ Rule 8210 Order, 2012 SEC LEXIS 3798, at *1; Exchange Act Release No. 60836, 2009 WL 3344377, at *1 (Oct. 16, 2009) (Notice of Filing of Proposed Rule Change; File No. SR-FINRA-2009-060) ("Notice") (emphasis added).

¹⁹ *Id.* (emphasis added).

and scope of Goldstein's outside business activity as a paid consultant for, and president of, Wall Street at Home. FINRA's investigation also included whether there was any misconduct arising from conflicts between Marquis, Goldstein, and Marquis's customers, including selling away, buying away, spinning, front-running, market manipulation, fraud, and violation of AML rules. FINRA's Rule 8210 requests concerned those aspects of the investigation because Wall Street at Home purported to run a full-service brokerage through its ownership of Marquis, and Goldstein, an associated person of Marquis, was the eighty percent owner and president of Wall Street at Home with sole control over all of Wall Street at Home's financial activities and records. FINRA had reason to question whether Goldstein's consulting work, or any investment or financial activity of Wall Street at Home, involved the possible illegal activity of Marquis. Moreover, because Marquis had offered interests in Wall Street at Home while owned by one of its associated persons (*i.e.*, Goldstein), FINRA's Rule 8210 requests were with respect to the investigation of possible conflicts in Marquis's business.

In addition, as an associated person, Goldstein may not "second guess" FINRA's requests for information, or "take it upon [himself] to determine whether information is material to [a FINRA] investigation of [his] conduct."²⁰ And "Rule 8210(a) has no requirement that [FINRA] explain its reasons for making the information request or justify its relevance."²¹

For the foregoing reasons, FINRA's information and document requests satisfied the requirement that requests under subsections (a)(1) and (a)(2) of Rule 8210 be "with respect to any matter involved in the investigation." Accordingly, because subsection (a)(1) has no additional limitations on its scope, and because Goldstein failed to provide testimony or information requested under that subsection, we find that Goldstein violated Rule 8210(a)(1).

FINRA's requests pursuant to subsection (a)(2) of Rule 8210 met the additional requirement that they be "of such member or person" associated with a member. In asserting that the documents requested are "of" a third party, Wall Street at Home, which is not a member or person associated with a member, and are not his documents to provide, Goldstein misconstrues FINRA's request.

FINRA's request falls within the ambit of Rule 8210(a)(2) because the documents are "of" Goldstein. Goldstein's ownership interest in the information and documents is established

²⁰ *CMG Institutional Trading, LLC*, Exchange Act Release No. 59325, 2009 SEC LEXIS 215, at *21, *26 (Jan. 30, 2009) (citation omitted); *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 SEC LEXIS 2598, at *18-19 (Nov. 8, 2007) ("As we have often noted, recipients of requests under Rule 8210 must promptly respond to the requests or explain why they cannot. They may not refuse such requests on the grounds of relevance or otherwise set conditions on their compliance, and [FINRA] is not required to justify its information requests in order to obtain compliance from members and their associated persons.").

²¹ *CMG Institutional Trading*, 2009 SEC LEXIS 215, at *26; *see also Ochanpaugh*, 2006 SEC LEXIS 1926, at *21 (explaining that "the only recourse against possible overreaching by [FINRA] is for the person to whom the [Rule 8210] request is directed to refuse to comply, and to appeal any consequent disciplinary action to the Commission").

through his eighty percent ownership of Wall Street at Home. Goldstein admitted in his motion for a stay before us that he had possession of the information and documents sought by FINRA, and that Goldstein is Wall Street at Home's president and sole officer with sole control over its finances, books, and records. That Wall Street at Home is not itself a FINRA member or associated person is immaterial to the conclusion that documents in which Goldstein has a majority ownership interest and over which he has sole possession and control are within the scope of Rule 8210's requirement that the documents be "of such member or person."

Moreover, FINRA has compelling enforcement objectives at stake.²² Specifically, Wall Street at Home is the indirect owner of Marquis through a holding company. Marquis is a member firm that is being investigated by FINRA. Further, Wall Street at Home has described its business plan in its private placement memorandum as to "operate a full service, retail securities brokerage business through [its] subsidiary, Marquis." Marquis also served as the placement agent for Wall Street at Home's 2003 offering in which Wall Street at Home sold units to Marquis's customers. These relationships and activities concern FINRA's enforcement objectives in understanding the possible involvement of Goldstein and Marquis in securities violations including selling away, buying away, spinning, front-running, market manipulation, fraud, and violation of AML rules.

Accordingly, we conclude that the documents requested here are within the scope of Rule 8210(a)(2). Because FINRA's document request fell squarely within the scope of subsection (a)(2), and because Goldstein failed to comply with that request, we find that Goldstein violated Rule 8210(a)(2).

C. Rule 8210 was applied consistently with the Exchange Act.

1. FINRA properly applied the version of Rule 8210 as it existed at the time of Goldstein's conduct.

We reject Goldstein's argument that the text of Rule 8210 did not require associated persons to produce documents in their "possession, custody or control" until the rule was amended after the relevant period here. His contention that such material was not covered by the version of Rule 8210 in effect at the time FINRA made its requests misapprehends both the scope of pre-amendment Rule 8210 and the issue addressed by the amendment—whether the rule applies to documents over which a member or associated person has possession, custody, or control but *does not* have an ownership interest. That issue is not implicated in this case, because as discussed above Goldstein has a majority ownership interest in the documents FINRA requested, and this alone made them unquestionably subject to Rule 8210 both before and after it was amended.

²² See *Ochanpaugh*, 2006 SEC LEXIS 1926, at *19-20 ("There may be circumstances in which possession and control of documents by [a FINRA] member or associated person, together with some other interest in the documents short of an ownership interest, may be sufficient given the enforcement objectives of [FINRA] to trigger application of the Rule.").

The 2013 amendment clarifying Rule 8210 was in response to our decision in *Ochanpaugh* in which we indicated that the pre-2013 text of Rule 8210 may extend to documents within the possession and control of an associated person, *even if owned by a third party*.²³ In that proceeding, NASD—a predecessor self-regulatory organization to FINRA—sought documents of a church of which Ochanpaugh was president on the grounds that Ochanpaugh had "possession and control" of the requested documents.²⁴ We held that the evidence did not support a finding that Ochanpaugh had such possession and control. In so deciding, we did not reach the question whether possession and control alone would be sufficient to establish whether the requested documents fell within the scope of Rule 8210. Instead, we left "it to NASD to develop further its analysis with respect to the scope of Rule 8210."²⁵

FINRA clarified the scope of Rule 8210 through the 2013 amendments. FINRA's amendment to Rule 8210, effective February 25, 2013, added the text italicized in the following excerpt: "For the purpose of an investigation . . . FINRA staff shall have the right to: . . . (2) inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation, complaint, examination, or proceeding *that is in such member's or person's possession, custody or control*."²⁶ The Supplementary Material to the amended Rule 8210 further provides:

In specifying the books, records and accounts "of such member or person," paragraph (a) of the rule refers to books, records and accounts that the broker-dealer or its associated persons make or keep relating to its operation as a broker-dealer or relating to the person's association with the member. This includes but is not limited to records relating to a FINRA investigation of outside business activities, private securities transactions or possible violations of just and equitable principles of trade, as well as other FINRA rules, MSRB rules, and the federal securities laws. It does not ordinarily include books and records that are in the possession, custody or control of a member or associated person, but whose

²³ Rule 8210 Order, 2012 SEC LEXIS 3798, at *5 n.10; *Ochanpaugh*, 2006 SEC LEXIS 1926, at *19-20.

²⁴ *Ochanpaugh*, 2006 SEC LEXIS 1926, at *17.

²⁵ *Id.* at *22. We noted in *Ochanpaugh* that, while we were not addressing the boundaries of Rule 8210(a)(2), "[t]here may be circumstances in which possession and control of documents by an NASD member or associated person, together with some other interest in the documents short of an ownership interest, may be sufficient [to extend Rule 8210 to documents that may belong to a third party] given the enforcement objectives of the NASD to trigger application of the Rule." *Id.* at *19-20. We also noted that, "[i]n other circumstances, the NASD's authority under the Rule might not extend to documents that may belong to a third party, or that may contain a third party's confidential information not closely related to securities trading with a member or associated person, even if those documents were in the possession and control of a member or associated person." *Id.* at *20.

²⁶ Rule 8210 Order, 2012 SEC LEXIS 3798, at *1; Notice, 2009 WL 3344377, at *1.

bona fide ownership is held by an independent third party and the records are unrelated to the business of the member.²⁷

Thus, neither FINRA's amendment to Rule 8210 nor the Commission decision in *Ochanpaugh* that prompted that amendment raised any doubt that the sort of ownership interest Goldstein has here was sufficient to make documents subject to pre-amendment Rule 8210.

Because Goldstein has an ownership interest in the records of Wall Street at Home through his eighty percent ownership of the company and those records are related to the business of both Marquis and Goldstein, they were within the scope of Rule 8210 prior to the 2013 amendments.

2. Goldstein has not been denied due process.

Goldstein contends that, while FINRA is a private entity, it should be deemed a "state actor" here because it is a government regulated entity exercising power granted to it, derivatively by Congress and through the Commission pursuant to the Exchange Act, to enforce the federal securities laws as they apply to its members and associated persons. As a "state actor," Goldstein contends that FINRA was required to provide him with Constitutional protections, and it failed to do so because Rule 8210 is "unconscionably vague" in violation of due process requirements.²⁸ We disagree.

To be subject to Constitutional due process scrutiny, a private entity's actions must be "fairly attributable" to the State.²⁹ Actions are "fairly attributable" to the State where "there is a sufficiently close nexus between the State and the challenged action."³⁰ Facts tending to "bear on the fairness of such an attribution" include whether a challenged action "results from the State's exercise of its coercive power"; whether "the State provides significant encouragement, either overt or covert"; or whether "a private actor operates as a willful participant in the joint activity with the State or its agents."³¹ But "[m]ere approval of or acquiescence in the initiatives

²⁷ *Id.*

²⁸ Goldstein cites to the Fourteenth Amendment in making his due process argument, which applies Fifth Amendment due process requirements to state governments. "The procedural due process protections under the Fifth and Fourteenth Amendments are the same." *English v. District of Columbia*, 717 F.3d 968, 972 (D.C. Cir. 2013).

²⁹ *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 295 (2001); *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 161 (2d Cir. 2002).

³⁰ *D.L. Cromwell Inv.*, 279 F.3d at 161 (quoting *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 351 (1974)). The Supreme Court in *Jackson* noted that "[t]he mere fact that a business is subject to state regulation does not by itself convert its action into that of the State for purposes of" Constitutional due process. *Jackson*, 419 U.S. at 350.

³¹ *Brentwood Acad.*, 531 U.S. at 296 (internal quotations omitted). The Supreme Court in *Brentwood* noted that "no one fact can function as a necessary condition across the board for

of a private party is not sufficient to justify holding the State responsible for those initiatives under the terms of the [due process clause]."³²

We have found repeatedly that "FINRA is not a state actor and thus, traditional Constitutional due process requirements do not apply to its disciplinary proceedings."³³ Numerous courts have also found that FINRA (and its predecessor, NASD) is not a state actor subject to Constitutional restrictions.³⁴ Moreover, the record does not reflect, and Goldstein does not point to, any evidence of a "sufficiently close nexus between the State" and FINRA's actions here.³⁵

Goldstein instead cites cases, *Weissman v. NASD* and *Austin Municipal Securities, Inc. v. NASD*, which both find the NASD entitled to absolute immunity for conduct in exercising its quasi-governmental authority.³⁶ But neither case finds that NASD is a state actor, and we have previously found such precedent not to "controvert the numerous decisions that squarely hold that NASD is a private actor."³⁷

(...continued)

finding state action; nor is any one set of circumstances absolutely sufficient, for there may be some countervailing reason against attributing activity to the government." *Id.* at 295-96.

³² *Blum v. Yaretsky*, 457 U.S. 991, 1004-05 (1982).

³³ *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at *34 (Oct. 20, 2011); *Asensio & Co., Inc.*, Exchange Act Release No. 68505, 2012 SEC LEXIS 3954, at *61 (Dec. 20, 2012) ("It is well established that the requirements of constitutional due process do not apply to FINRA because FINRA is not a state actor.").

³⁴ *See, e.g., Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) ("The NASD is a private actor, not a state actor. It is a private corporation that receives no federal or state funding. Its creation was not mandated by statute, nor does the government appoint its members or serve on any NASD board or committee."); *Jones v. SEC*, 115 F.3d 1173, 1183 (4th Cir. 1997).

³⁵ In support of his argument that FINRA is a state actor, Goldstein attached as an exhibit to his reply brief a May 1, 2013 letter from FINRA in an unrelated proceeding. In the letter, FINRA asserted an entitlement to the governmental investigatory file privilege in response to a subpoena request. We treat Goldstein's submission of this letter as a motion to adduce additional evidence pursuant to Rule of Practice 452, 17 C.F.R. § 201.452, which requires that Goldstein "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." Goldstein did not make this showing because the letter does not address whether FINRA may be deemed a state actor in the context of a Rule 8210 request and is therefore irrelevant in this proceeding. Nevertheless, we admit the letter in an exercise of discretion.

³⁶ *Weissman v. NASD*, 468 F.3d 1306, 1313 (11th Cir. 2006); *Austin Mun. Sec., Inc. v. NASD*, 757 F.2d 676, 692-93 (5th Cir. 1985).

³⁷ *Fawcett*, 2007 SEC LEXIS 2598, at *4 n.19; *see also Scher v. NASD*, 386 F. Supp. 2d 402, 408 (S.D.N.Y. 2005) ("[I]t is by no means inconsistent to find that, on the one hand, the NASD exercises insufficient state action to trigger constitutional protections . . . while nevertheless

(continued...)

Goldstein also notes that in *Crimmins v. American Stock Exchange, Inc.*, a district court held that the American Stock Exchange "engage[s] in governmental action" when it conducts disciplinary proceedings.³⁸ But *Crimmins* is not good authority for Goldstein's assertion that FINRA is a state actor because the Second Circuit subsequently found that FINRA's predecessor NASD was "not a state actor."³⁹

Goldstein further notes a Report of the Senate Banking, Housing and Urban Affairs Committee concerning 1975 amendments to the Exchange Act, which states: "Recognizing that the self-regulatory organizations utilize governmental-type powers in carrying out their responsibilities under the Exchange Act highlights the fact that these organizations must be required to conform their activities to fundamental standards of due process."⁴⁰ But the Report was referring to the need for Exchange Act requirements for self-regulatory organizations to provide members and associated persons with procedural fairness.⁴¹ As we find below, Goldstein has not been denied the procedural protections of the Exchange Act.

Goldstein also contends that the issue of whether FINRA is a state actor is "unresolved." But the cases he cites—*Rooms v. SEC* and *Erenstein v. SEC*—are inapposite.⁴² *Rooms* concerned whether the Commission violated the petitioner's due process rights; it did not involve whether NASD was a state actor or whether NASD violated the petitioner's due process rights.⁴³ And the court in *Erenstein* determined not to decide the issue of "whether the NASD is a state actor subject to due process requirements," choosing instead to "assume, for the limited purpose of deciding th[e] appeal, that the NASD could be a governmental actor."⁴⁴

Even if FINRA were deemed to be a state actor, we find no merit to Goldstein's contention that Rule 8210 is impermissibly vague. A regulation is impermissibly vague only if it "fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so

(...continued)

holding that the NASD is entitled to absolute immunity in the exercise of its quasi-public regulatory duties.") (internal quotations omitted), *aff'd on other grounds*, 218 F. App'x 46 (2d Cir. 2007).

³⁸ 346 F. Supp. 1256, 1259 (S.D.N.Y. 1972).

³⁹ *Desiderio*, 191 F.3d at 206. Goldstein's citation to *Bruan, Gordon & Co. v. Hellmers*, 502 F. Supp. 897, 902 (S.D.N.Y. 1980), in support of this point is unavailing for the same reason.

⁴⁰ S. Rep. No. 94-75, at 25 (1975).

⁴¹ *See id.* at 24-26.

⁴² *Rooms v. SEC*, 444 F.3d 1208 (10th Cir. 2006); *Erenstein v. SEC*, 316 F. App'x 865 (11th Cir. 2008).

⁴³ *Rooms*, 444 F.3d at 1213-14 ("Rooms argues that the SEC violated his due process rights by upholding the permanent bar after finding that he did not violate Rule 8210.").

⁴⁴ *Erenstein*, 316 F. App'x at 871-72.

standardless that it authorizes or encourages seriously discriminatory enforcement."⁴⁵ Goldstein contends that Rule 8210 is too broad because (i) the term "any matter involved in the investigation" "leaves open the possibility that the Rule governs everything in the world and thus has no limits";⁴⁶ and (ii) the term "of such member or person" is undefined and "leaves open for interpretation the extent to which it applies to the production of documents and information belonging to a non-member, non-associated person, third-party." But as discussed above, Rule 8210 has discernible parameters and the material requested from Goldstein fell squarely within the Rule's scope. Goldstein therefore had fair notice that his conduct was contrary to Rule 8210.⁴⁷

3. Goldstein has not been denied the procedural protections required by the Exchange Act.

Although Constitutional due process is not applicable to FINRA, FINRA must nevertheless provide procedural protections for members and associated persons in its disciplinary proceedings pursuant to Exchange Act Sections 15A(B)(8) and 15A(H)(1).⁴⁸ Goldstein argues that the application of Rule 8210 violated the fairness principles embodied in these sections of the Exchange Act by leaving him unable to challenge FINRA's authority to issue the information requests without first submitting to a suspension or bar.

But requiring an associated person to submit to disciplinary proceedings before determining the scope of FINRA's authority to request information does not violate the fairness requirements of the Exchange Act.⁴⁹ Rather, requiring Goldstein to exhaust his administrative remedies before FINRA serves an important public interest by promoting the development of a record at the SRO level and giving the SRO an opportunity to resolve disputes.⁵⁰ We have noted

⁴⁵ *FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012) (quoting *United States v. Williams*, 553 U.S. 285, 304 (2008)).

⁴⁶ In fact, Rule 8210 specifically limits this term to an investigation "authorized by the FINRA By-Laws or rules."

⁴⁷ See *Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 495 (1982) ("A plaintiff who engages in some conduct that is clearly proscribed cannot complain of the vagueness of the law as applied to the conduct of others."); *Parker v. Levy*, 417 U.S. 733, 756 (1974) ("One to whose conduct a statute clearly applies may not successfully challenge it for vagueness.").

⁴⁸ Section 15A(B)(8) of the Exchange Act, 15 U.S.C. § 78o-3(b)(8), as relevant here, requires FINRA to provide a fair procedure for disciplining persons associated with members. Section 15A(H)(1) of the Exchange Act, 15 U.S.C. § 78o-3(h)(1), in relevant part, requires FINRA, in any proceeding to determine whether a person associated with a member should be disciplined, to bring specific charges, notify such person of, and give him an opportunity to defend against, such charges, and keep a record of such proceedings.

⁴⁹ *Berger v. SEC*, 347 F. App'x 692, 694-95 (2d Cir. 2009).

⁵⁰ *MFS Secs. Corp. v. SEC*, 380 F.3d 611, 621-22 (2d Cir. 2004).

that "subjecting oneself to [FINRA's] disciplinary process and relying on [FINRA's] procedures is the appropriate route to challenge [FINRA] jurisdiction."⁵¹

In appealing FINRA's decision and seeking a stay of FINRA's sanctions pending appeal, Goldstein now has the opportunity to argue against FINRA's jurisdiction to issue the information requests. FINRA informed Goldstein at the beginning of his OTR that any failure to provide information could lead to disciplinary proceedings, and the Notice of Suspension provided Goldstein with notice of the specific charges being brought against him. Goldstein requested and obtained a hearing, where he fully defended himself with the assistance of counsel, before the imposition of discipline. Accordingly, we find no evidence that FINRA failed to provide Goldstein with the fair procedures required by Sections 15A(B)(8) and 15A(H)(1).

4. FINRA is not precluded from requesting confidential and private information.

Goldstein also asserts that compliance with FINRA's requests would result in the provision to FINRA of "confidential and private" information and documents that would, in turn, become available to competitors of Wall Street at Home and "any other person or entity that saw fit to subpoena them." Goldstein contends that these considerations raise a "question as to whether FINRA is conducting an unduly burdensome investigation or examination on a bad faith basis." That argument fails for several reasons.

Goldstein consented as an associated person to FINRA's ability under Rule 8210 to request business records such as those FINRA seeks here.⁵² The possibility that a third party could subpoena non-public and confidential information provided to FINRA should not trump FINRA's ability to request it.⁵³ Because much of the information that FINRA needs to conduct

⁵¹ *Howard Brett Berger*, Exchange Act Release No. 55706, 2007 SEC LEXIS 895, at *21 (May 4, 2007), *reconsideration in part on other grounds*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141 (Nov. 14, 2008), *petition denied*, 347 F. App'x 692 (2d Cir. 2009); *see also Ochanpugh*, 2006 SEC LEXIS 1926, at *21 (explaining that "the only recourse against possible overreaching by [FINRA] is for the person to whom the [Rule 8210] request is directed to refuse to comply, and to appeal any consequent disciplinary action to the Commission").

⁵² *Ochanpugh*, 2006 SEC LEXIS 1926, at *20-21 (FINRA's "authority to request documents pursuant to Rule 8210 stems from the contractual relationship entered into voluntarily by [FINRA] members and associated persons with [FINRA]."); *Morton Bruce Erenstein*, Exchange Act Release No. 56768, 2007 SEC LEXIS 2596, at *19 (Nov. 8, 2007) ("Erenstein's contractual relationship with [FINRA], entered into when he became an associated person with [a FINRA] member, included his agreement to abide by all its rules."), *aff'd*, 316 F. App'x 865 (11th Cir. 2008).

⁵³ *See, e.g., Erenstein*, 2007 SEC LEXIS 2596, at *17-19 (rejecting associated person's argument that, because "tax returns are confidential communications between the taxpayer and the taxing authority," such documents are discoverable only if they are clearly relevant and there is no other available source of the information requested). Moreover, FINRA's guidance on its

(continued...)

its investigations is non-public and confidential, FINRA's ability to police the activities of its members and associated persons would be eviscerated if FINRA could not request such information under Rule 8210.⁵⁴

Moreover, we find no basis in the record for Goldstein's assertion that FINRA is conducting its investigation in an unduly burdensome manner or in bad faith.

Accordingly, for the foregoing reasons, we find that Goldstein engaged in the conduct found by FINRA, that such conduct violates Rule 8210, and that Rule 8210 is, and was applied in a manner, consistent with the purposes of the Exchange Act.

III. Analysis of Sanctions

A. Standard of Review

Pursuant to Exchange Act Section 19(e)(2), we will sustain a FINRA sanction unless we find, "having due regard for the public interest and the protection of investors," that the sanction is excessive or oppressive or imposes an unnecessary or inappropriate burden on competition.⁵⁵ As part of this review, we must consider any aggravating or mitigating factors⁵⁶ and whether the sanctions imposed by FINRA are remedial in nature and not punitive.⁵⁷

Although the Commission is not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2).⁵⁸ Where, as here,

(...continued)

enforcement process states that "FINRA investigations are non-public and confidential." FINRA Regulatory Notice 09-17, 2009 FINRA LEXIS 45, at *4 (Mar. 2009).

⁵⁴ See *CMG Institutional Trading*, 2009 SEC LEXIS 215, at *15 (stressing the importance of Rule 8210 in connection with FINRA's "obligation to police the activities of its members and associated persons") (quoting *Paz Sec., Inc.*, Exchange Act Release No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008)).

⁵⁵ 15 U.S.C. § 78s(e)(2). Goldstein does not claim, and the record does not show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

⁵⁶ *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

⁵⁷ *Paz Sec.*, 494 F.3d at 1065 ("The purpose of the order [must be] remedial, not penal.") (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940); see also FINRA Sanction Guidelines at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.")).

⁵⁸ *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 SEC LEXIS 1699, at *41 (June 14, 2013). We also acknowledge that the Sanction Guidelines "do not prescribe fixed sanctions for particular violations" and "are not intended to be absolute." FINRA Sanction Guidelines at 1.

an individual has provided a partial but incomplete response to requests made by FINRA pursuant to Rule 8210, the Sanction Guidelines state that a bar is standard "*unless* the person can demonstrate that the information provided substantially complied with all aspects of the request."⁵⁹ The Sanction Guidelines note further that an adjudicator should "consider suspending the individual in any or all capacities for up to two years" where mitigation exists.⁶⁰

The Sanction Guidelines also identify three "principal considerations" for determining sanctions where an individual has provided a partial but incomplete response to Rule 8210 requests. They are (i) the "[i]mportance of the information requested that was not provided as viewed from FINRA's perspective, and whether the information provided was relevant and responsive to the request"; (ii) the "[n]umber of requests made, the time the respondent took to respond, and the degree of regulatory pressure required to obtain a response"; and (iii) "[w]hether the respondent thoroughly explains valid reason(s) for the deficiencies in the response."⁶¹

B. The panel's decision to bar Goldstein was neither excessive nor oppressive.

The panel's decision to bar Goldstein is supported by application of the above considerations. First, Goldstein has not attempted to demonstrate that the information he provided to FINRA "substantially complied with all aspects of" its Rule 8210 requests. To the contrary, Goldstein refuses to provide FINRA with the majority of the information and documents it has requested concerning Wall Street at Home. This includes the information and documents specified in all eight of the requests in FINRA's letter to Goldstein dated February 3, 2012.

Second, the requested information that Goldstein refuses to provide is important. It concerns the nature and scope of Goldstein's outside business activity at Wall Street at Home, as well as whether any conflicts exist between Goldstein, Marquis, and Marquis's customers, and potential issues such as selling away, buying away, spinning, front-running, market manipulation, fraud, and violation of AML rules.

Third, FINRA was required to exert significant regulatory pressure in seeking the requested material. After Goldstein refused to provide information and documents concerning Wall Street at Home at the OTR and in response to the subsequent Rule 8210 request, FINRA issued a Notice of Suspension and then held a hearing. The panel provided Goldstein with additional time to respond to FINRA's outstanding requests and then suspended him before

⁵⁹ FINRA Sanction Guidelines at 33 (emphasis added). The Sanction Guidelines distinguish between complete and partial failures to respond. *See id.* Where an individual has failed to respond in any manner to Rule 8210 requests, the Sanction Guidelines state that a bar should be standard. *Id.*

⁶⁰ *Id.* The Sanction Guidelines include a list of non-exhaustive aggravating and mitigating factors. *See id.* at 6-7.

⁶¹ *Id.* at 33.

imposing a bar. Despite its efforts and expenditure of resources, FINRA was still unable to obtain Goldstein's compliance.

Fourth, Goldstein has provided no valid reason for refusing to respond to FINRA's requests. As discussed above, Goldstein's arguments that FINRA's requests are outside the scope of Rule 8210 are without merit, as are his arguments concerning due process and the Exchange Act's procedural protections. Goldstein also has admitted that the requested materials are within his possession. He therefore has no excuse for failing to comply with FINRA's requests, especially considering the numerous opportunities FINRA afforded him to do so before imposing a bar.

Fifth, Goldstein has not asserted, and the record does not reflect, any mitigating factors. But there is at least one aggravating factor. The Sanction Guidelines include as an aggravating factor "whether the respondent attempted to . . . conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA."⁶² The panel found that Goldstein "was not credible" when he claimed during the OTR that he could not remember certain information sought by FINRA.⁶³ Specifically, Goldstein testified that he could not recall whether Wall Street at Home ever had an outside brokerage account. We agree that this statement lacks credibility considering that Goldstein was the president and sole officer of Wall Street at Home, and that Wall Street at Home had no employees.

Finally, the bar is remedial and not punitive. We have stressed the importance of Rule 8210 in connection with FINRA's "obligation to police the activities of its members and associated persons."⁶⁴ Without subpoena power, FINRA "must rely on Rule 8210 to obtain information from its members necessary to carry out its investigations and fulfill its regulatory mandate."⁶⁵ It is therefore "critically important to the self-regulatory system that members and associated persons cooperate with [FINRA] investigations."⁶⁶ Failure to respond to Rule 8210 requests "impedes [FINRA's] ability to detect misconduct that threatens investors and markets."⁶⁷

⁶² FINRA Sanction Guidelines at 7.

⁶³ Hearing Panel Decision at 14.

⁶⁴ *CMG Institutional Trading*, 2009 SEC LEXIS 215, at *15 (quoting *Paz Sec.*, 2008 SEC LEXIS 820, at *12).

⁶⁵ *Id.* at *15.

⁶⁶ *Erenstein*, 316 F. App'x at 871.

⁶⁷ *Berger*, 2008 SEC LEXIS 3141, at *13-14; see also *Joseph Patrick Hannan*, Exchange Act Release No. 40438, 1998 SEC LEXIS 1955, at *9 (Sept. 14, 1998) ("We have repeatedly stressed the importance of cooperation in [FINRA] investigations Failures to comply [with Rule 8210 requests] are serious violations because they subvert [FINRA's] ability to carry out its regulatory responsibilities.").

Goldstein's misconduct was therefore serious, and a bar will protect the public by encouraging others to respond to Rule 8210 requests completely and in a timely manner.⁶⁸

Moreover, as noted, the panel did not immediately impose a bar, and instead provided Goldstein with additional time to comply with FINRA's outstanding requests. It first gave Goldstein twenty-one days to comply before imposing a suspension and then another three months to terminate the suspension through compliance before imposing the bar.

In light of Goldstein's persistent refusal to comply with FINRA's outstanding requests even after being ordered to do so by the hearing panel, we find that the bar serves the additional remedial purpose of protecting the public by removing Goldstein from the industry. Goldstein's willingness to defy the regulatory process and impede FINRA's investigation into potentially serious misconduct indicates that Goldstein poses a continuing danger to the investing public that is appropriately remedied by a bar.

Accordingly, for the foregoing reasons, we find that the bar imposed on Goldstein is neither excessive nor oppressive within the meaning of Exchange Act Section 19(e).

C. The \$50,000 fine imposed is inconsistent with the Sanction Guidelines.

Where an individual has provided a partial but incomplete response to Rule 8210 requests, the Sanction Guidelines state that a fine of \$10,000 to \$50,000 is standard.⁶⁹ But the Sanction Guidelines further provide that "[a]djudicators generally should not impose a fine if an individual is barred and there is no customer loss in cases involving . . . failure to respond under FINRA Rule 8210."⁷⁰ The panel did not consider this latter provision.

⁶⁸ See *Siegel*, 592 F.3d at 158 (noting that deterrence may be considered as part of the overall remedial inquiry in determining sanctions); *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) (same).

⁶⁹ FINRA Sanction Guidelines at 33. The three "principal considerations" discussed above are also applied to the determination of whether to impose a fine. *Id.*

⁷⁰ *Id.* at 10.

Accordingly, as Goldstein has been barred and as no customer loss has been shown, we set aside the fine imposed by the panel.

An appropriate order will issue.⁷¹

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, and STEIN; Commissioner PIWOWAR not participating).

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

⁷¹ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 71970 / April 17, 2014

Admin. Proc. File No. 3-15183

In the Matter of the Application of

GREGORY EVAN GOLDSTEIN
c/o Martin P. Unger
Wexler Burkhart Hirschberg & Unger, LLP
377 Oak Street, Concourse 2
Garden City, NY 11530

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING IN PART DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the findings by FINRA that Gregory Evan Goldstein violated FINRA Rule 8210 be, and they hereby are, SUSTAINED; and it is further

ORDERED that the sanctions imposed by FINRA against Gregory Evan Goldstein are SUSTAINED, except that the fine is SET ASIDE.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71967 / April 17, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3819 / April 17, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15548

In the Matter of

PHILIP MARK CAIN,

Respondent.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940**

I.

On October 1, 2013, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Philip Mark Cain ("Respondent" or "Cain").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From August 2006 through August 2010, Respondent was a registered representative with Commonwealth Financial Network, a dually registered investment adviser and broker-dealer. From September 2010 to March 2011, Respondent was also a registered

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representative associated with H. Beck, Inc., a dually registered investment adviser and broker-dealer. Respondent, 50 years old, is a resident of Tucson, Arizona.

2. On December 14, 2011, Cain pleaded guilty to one count each of mail fraud in violation of 18 U.S.C. Section 1341, engaging in an illegal monetary transaction greater than \$10,000 in violation of 18 U.S.C. Section 1957, and structuring transactions to evade currency reporting requirements in violation of 31 U.S.C. Sections 5324(a)(3) and (d)(2) before the United States District Court for the District of Arizona. *U.S. v. Philip Mark Cain*, 4:11-CR-1105-JGZ. On March 15, 2012, a Judgment in a Criminal Case was entered against Cain. He was sentenced to 51 months in prison followed by five years of supervised release and ordered to pay \$1,272,943.89 in restitution.

3. The counts of the indictment to which Cain pleaded guilty alleged, among other things, that between June 2008 and February 2011, Cain participated in a scheme and artifice to obtain money or property by means of materially false or fraudulent pretenses, representations or promises. More specifically, the indictment alleged that Cain defrauded seven investors out of approximately \$1.4 million by purporting to purchase structured notes on their behalf. Cain did not at any time invest any of the investors' funds in structured notes and instead used their funds to purchase and repair classic cars.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Cain's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Cain be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order;
and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct
that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-71958; File No. S7-05-14]

RIN 3235-AL45

Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the Securities and Exchange Commission ("Commission"), pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), is proposing recordkeeping, reporting, and notification requirements applicable to security-based swap dealers ("SBSDs") and major security-based swap participants ("MSBSPs"), securities count requirements applicable to certain SBSDs, and additional recordkeeping requirements applicable to broker-dealers to account for their security-based swap and swap activities. The Commission also is proposing an additional capital charge provision that would be added to the proposed capital rule for certain SBSDs. Finally, the Commission is proposing technical amendments to the broker-dealer recordkeeping, reporting, and notification requirements.

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-05-14 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Kevin M. O'Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-05-14. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

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I. BACKGROUND

On July 21, 2010, President Obama signed the Dodd-Frank Act into law.¹ Title VII of the Dodd-Frank Act ("Title VII") established a new regulatory framework for the over-the-counter ("OTC") derivatives markets.² In this regard, Title VII was enacted, among other reasons, to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and regulation of SBSs and MSBSs; (2) imposing clearing and trade execution requirements on swaps and security-based swaps, subject to certain exceptions; (3) creating recordkeeping and real-time reporting regimes;

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat. 1376 (2010).

² Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010." See Pub. L. 111-203, 701. The Dodd-Frank Act assigns responsibility for the oversight of the U.S. OTC derivatives markets to the Commission, the Commodity Futures Trading Commission ("CFTC"), and certain prudential regulators. The term prudential regulator is defined in section 1(a)(39) of the Commodity Exchange Act ("CEA") (7 U.S.C. 1(a)(39)) and that definition is incorporated by reference in section 3(a)(74) of the Exchange Act (15 U.S.C. 78c(a)(74)). Pursuant to the definition, the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the "prudential regulators") is the prudential regulator of an SBS, MSBS, swap participant, or major swap participant if the entity is directly supervised by that agency. The Commission has oversight authority with respect to a security-based swap as defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)), including to implement a registration and oversight program for a security-based swap dealer as defined in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)) and a major security-based swap participant as defined in section 3(a)(67) of the Exchange Act (15 U.S.C. 78c(a)(67)). The CFTC has oversight authority with respect to a swap as defined in section 1(a)(47) of the CEA (7 U.S.C. 1(a)(47)), including to implement a registration and oversight program for a swap dealer as defined in section 1(a)(49) of the CEA (7 U.S.C. 1(a)(49)) and a major swap participant as defined in section 1(a)(33) of the CEA (7 U.S.C. 1(a)(33)). The Commission and the CFTC jointly have adopted rules to further define, among other things, the terms swap, swap dealer, major swap participant, security-based swap, security-based swap dealer, and major security-based swap participant. See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208 (Aug. 13, 2012) (joint Commission/CFTC final rule); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012) (joint Commission/CFTC final rule).

and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight.³

Section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.⁴ Section 15F(f)(2) provides that the Commission shall adopt rules governing reporting and recordkeeping for SBSDs and MSBSPs.⁵ Section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.⁶ Section 15F(f)(1)(B)(ii) provides that SBSDs and MSBSPs without a prudential regulator (respectively, "nonbank SBSDs" and "nonbank MSBSPs") shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁷ Section 15F(f)(1)(B)(i) provides that SBSDs and MSBSPs for which there is a prudential regulator (respectively, "bank SBSDs" and "bank MSBSPs") shall keep books and records of all activities related to their business as an SBSD or MSBSP in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁸ Section 15F(g) of the Exchange Act requires SBSDs and MSBSPs to maintain daily trading records with respect to security-based swaps and provides that the Commission shall adopt rules governing daily trading records for SBSDs and MSBSPs.⁹

³ See Pub. L. 111-203, 701 through 774.

⁴ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10.

⁵ See 15 U.S.C. 78o-10(f)(2).

⁶ See 15 U.S.C. 78o-10(f)(1).

⁷ See 15 U.S.C. 78o-10(f)(1)(B)(ii). A nonbank SBSD or nonbank MSBSP could be dually registered with the Commission as a broker-dealer (respectively, a "broker-dealer SBSD" or "broker-dealer MSBSP") or registered with the Commission only as an SBSD or MSBSP (respectively, a "stand-alone SBSD" or "stand-alone MSBSP"). Any of these registrants or a bank SBSD or bank MSBSP also could register with the CFTC as a futures commission merchant ("FCM"), swap dealer, or major swap participant.

⁸ See 15 U.S.C. 78o-10(f)(1)(B)(i).

⁹ See 15 U.S.C. 78o-10(g).

Finally, section 15F(i)(2) of the Exchange Act provides that the Commission shall adopt rules governing documentation standards for SBSDs and MSBSPs.¹⁰

The Commission anticipates that a number of broker-dealers will register as SBSDs (broker-dealer SBSDs) or potentially as MSBSPs ("broker-dealer MSBSPs").¹¹ Further, the Commission expects that some broker-dealers that are not registered as an SBSD or an MSBSP nonetheless will engage in security-based swap and swap activities.¹² The Commission has authority under section 17(a)(1) of the Exchange Act to adopt rules requiring broker-dealers – which would include broker-dealer SBSDs and broker-dealer MSBSPs – to make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest,

¹⁰ See 15 U.S.C. 78o-10(i).

¹¹ While it is anticipated that some broker-dealers and banks will register as SBSDs in order to engage in security-based swap activities, it is unclear whether broker-dealers or banks will register as MSBSPs. For example, a broker-dealer or bank may be required to register as an MSBSP because of the nature of its security-based swap activities. See 15 U.S.C. 78a(c)(67) (defining the term major security-based swap participant); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR 30596 (further defining the term major security-based swap participant). In this case, the broker-dealer or bank may conclude that it is more efficient to register as an SBSD in order to engage in security-based swap activities permitted of an SBSD but not of an MSBSP. Nonetheless, because a broker-dealer or bank could register as an MSBSP, the proposed rules and the discussion in this release contemplate these categories of registrants. A broker-dealer MSBSP would be subject to all the securities laws applicable to a broker-dealer, including capital, margin, segregation, recordkeeping, reporting, notification, and securities count requirements, and to any additional requirements that would be applicable only to MSBSPs. Similarly, a bank MSBSP would be subject to all laws and regulations applicable to a bank and to any additional requirements that would be applicable only to MSBSPs.

¹² The term security-based swap dealer is defined in section 3(a)(71) of the Exchange Act. See 15 U.S.C. 78c(a)(71). The definition excludes an entity that enters into security-based swaps agreements for its own account, either individually or in a fiduciary capacity, but not as a part of a regular business. See 15 U.S.C. 78c(a)(71)(C). Further, section 3(a)(71)(D) provides that the Commission shall exempt from designation as an SBSD an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers and that the Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt. See 15 U.S.C. 78c(a)(71)(D). The Commission has adopted Rule 3a71-2 to establish a de minimis exception under section 3(a)(71)(D) of the Exchange Act. See 17 CFR 240.3a71-2; Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR at 30635–30643.

for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.¹³

The Commission also is proposing largely technical amendments to the broker-dealer recordkeeping, reporting, and notification rules.¹⁴

Pursuant to sections 15F and 17(a) of the Exchange Act, the Commission is proposing to amend Rules 17a-3, 17a-4, 17a-5, and 17a-11 to establish a recordkeeping, reporting, and notification program for broker-dealer SBSs and broker-dealer MSBSs. The amendments to

¹³ See 15 U.S.C. 78q(a)(1). Section 771 of the Dodd-Frank Act states that unless otherwise provided by its terms, Subtitle B of Title VII (relating to the regulation of the security-based swap markets) does not divest any appropriate Federal banking agency, the Commission, the CFTC, or any other Federal or State agency, of any authority derived from any other provision of applicable law. See Pub. L. 111-203, 771.

¹⁴ See 17 CFR 240.17a-3 ("Rule 17a-3"); 17 CFR 240.17a-4 ("Rule 17a-4"); 17 CFR 240.17a-5 ("Rule 17a-5"); 17 CFR 240.17a-11 ("Rule 17a-11"). The Dodd-Frank Act amended the definition of security in section 3(a)(10) of the Exchange Act to include a security-based swap. See Pub. L. 111-203, 761(a)(2); 15 U.S.C. 78c(a)(10). Therefore, the term security as used in Rules 17a-3, 17a-4, 17a-5, and 17a-11 includes a security-based swap, and any requirement in those rules relating to a security applies to a security-based swap. The Commission, however, has issued temporary exemptive relief to address the effect that the amendment to the definition of security would have on requirements in Exchange Act provisions and rules that did not otherwise apply specifically to security-based swaps prior to the amendment. See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 64795 (July 1, 2011), 76 FR 39927 (July 7, 2011) ("[R]egistered broker-dealers will solely be exempt from those provisions and rules to the extent that those provisions or rules do not apply to the broker's or dealer's security-based swap positions or activities as of July 15, 2011 – the day before the effectiveness of the change to the "security" definition. In other words, during the exemptive period the application of current law will remain unchanged, and those particular Exchange Act requirements will continue to apply to registered broker-dealers' security-based swap activities and positions to the same extent they apply currently. This approach is intended to help avoid undue market disruptions resulting from the change to the "security" definition, while at the same time preserving the current application of those particular provisions or rules to security-based swap activity by registered broker-dealers. Thus, under this approach of preserving the status quo, no exemption will be provided in connection with the [requirements in Exchange Act sections 17(a) and 17(b) and Rules 17a-3, 17a-4, 17a-5, 17a-8, and 17a-13] under the Exchange Act to the extent that those requirements currently apply to registered broker-dealer activities or positions involving instruments that will be security-based swaps (but registered broker-dealers will be exempted in connection with those requirements to the extent that the requirements do not already apply to activities or positions involving those instruments."); Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 68864 (Feb. 7, 2013), 78 FR 10218 (Feb. 13, 2013) (extending exemptive relief through February 11, 2014); Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, Exchange Release No. 71485 (Feb. 5, 2014) (extending exemptive relief with respect to Rules 17a-3, 17a-4, 17a-5, 17a-11, and 17a-13 until the earliest compliance date set forth in any final rules regarding recordkeeping and reporting requirements for SBSs and MSBSs). The Commission expects that the adoption of the amendments contemplated herein would eliminate the need for temporary exemptive relief from section 17(a) and section 17(b) of the Exchange Act and Rules 17a-3, 17a-4, 17a-5, 17a-11, and 17a-13 thereunder.

Rules 17a-3 and 17a-4 would establish additional recordkeeping requirements applicable to broker-dealers that are not dually registered as an SBSD or MSBSP to the extent they engage in security-based swap or swap activities.

Pursuant to section 15F of the Exchange Act, the Commission is proposing new Rules 18a-5 through 18a-9.¹⁵ These new rules would establish a recordkeeping, reporting, and notification program for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, and securities count requirements for stand-alone SBSDs.¹⁶ In addition, pursuant to sections 15F and 17(a) of the Exchange Act, the Commission is proposing new FOCUS Report Form SBS ("Form SBS") that would be used by all types of SBSDs and MSBSPs to report financial and operational information and, in the case of broker-dealer SBSDs and broker-dealer MSBSPs, replace their use of Part II, Part IIA, Part IIB, or Part II CSE of the Financial and Operational Combined Uniform Single Report ("FOCUS Report").¹⁷

The proposed new rules are modeled on broker-dealer Rules 17a-3, 17a-4, 17a-5, 17a-11, and 17a-13, and on the FOCUS Report. Specifically: (1) proposed Rules 18a-5 and 18a-6 (the

¹⁵ The Commission has proposed new Rules 18a-1 through 18a-4 to establish capital and margin requirements for SBSDs and MSBSPs, segregation requirements for SBSDs, and notification requirements with respect to segregation for SBSDs and MSBSPs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

¹⁶ The Commission is not proposing securities count requirements for stand-alone MSBSPs or bank SBSDs. Broker-dealer SBSDs and broker-dealer MSBSPs would be subject to the existing securities count rule applicable to broker-dealers – Rule 17a-13. 17 CFR 240.17a-13. The Commission is not proposing amendments to Rule 17a-13. While in this release Rule 17a-11 is referred to as a notification rule and Rule 17a-13 is referred to as a securities count rule, Rule 17a-11 can be viewed as a reporting rule and Rule 17a-13 can be viewed as a recordkeeping rule. See Prompt Notice of Net Capital or Recordkeeping Violations, Exchange Act Release No. 9268 (July 29, 1971), 36 FR 14725 (Aug. 11, 1971) (adopting Rule 17a-11, in part, under section 17(a) of Exchange Act, which, as discussed above, requires a broker-dealer to make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act); Quarterly Securities Counts by Certain Exchange Members, Brokers and Dealers, Exchange Act Release No. 9376 (Oct. 29, 1971), 36 FR 21178 (Nov. 4, 1971) (similarly adopting Rule 17a-13, in part, under section 17(a) of Exchange Act).

¹⁷ A broker-dealer must file the FOCUS Report Part II, Part IIA, Part IIB, or Part II CSE depending on the type of broker-dealer. A more detailed discussion of the FOCUS Report appears below in section II.B.2. of this release.

new recordkeeping rules) are modeled on Rules 17a-3 and 17a-4, respectively (the broker-dealer recordkeeping rules);¹⁸ (2) proposed Rule 18a-7 and proposed Form SBS (the new reporting rules) are modeled on Rule 17a-5 and on the FOCUS Report, respectively (the broker-dealer reporting rules);¹⁹ (3) proposed Rule 18a-8 (the new notification rule) is modeled on Rule 17a-11 (the broker-dealer notification rule);²⁰ and (4) proposed Rule 18a-9 (the new securities count rule) is modeled on the Rule 17a-13 (the broker-dealer securities count rule).²¹

The broker-dealer recordkeeping, reporting, notification, and security count requirements served as the model for the proposals because SBSDs and MSBSPs are expected to operate in financial markets and effect financial transactions that are similar to the financial markets in which broker-dealers operate and the financial transactions that broker-dealers effect.²² In addition, as discussed below, the objectives of these broker-dealer requirements are similar to the objectives underlying the proposals regarding security-based swaps. Moreover, the broker-dealer requirements have existed for many years and have established a system of recordkeeping for securities transactions that reflect and support prudent business practices and accountability of broker-dealers and have facilitated the ability of securities regulators to review and monitor compliance with securities laws.²³ Consequently, the Commission preliminarily believes the

¹⁸ Compare proposed Rule 18a-5, with 17 CFR 240.17a-3; compare proposed Rule 18a-6, with 17 CFR 240.17a-4.

¹⁹ Compare proposed Rule 18a-7, with 17 CFR 240.17a-5; compare proposed Form SBS, with the FOCUS Report.

²⁰ Compare proposed Rule 18a-8, with 17 CFR 240.17a-11.

²¹ Compare proposed Rule 18a-9, with 17 CFR 240.17a-13.

²² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70216 (stating a similar rationale for basing the proposed capital, margin, and segregation requirements for SBSDs on the broker-dealer capital, margin, and segregation requirements).

²³ See, e.g., Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media Under the Electronic Signatures in Global and National Commerce Act of 2000 With Respect to Rule 17a-4(f), Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001).

broker-dealer requirements provide an appropriate template on which to model a recordkeeping, reporting, and notification program for SBSDs and MSBSPs and a securities count program for SBSDs. Furthermore, as discussed above, it is expected that some nonbank SBSDs will dually register as broker-dealers in order to be able to offer customers a broader range of securities-based services than would be permitted of a nonbank SBSD.²⁴ Therefore, establishing consistent requirements could avoid potential competitive disparities between stand-alone SBSDs and broker-dealer SBSDs with respect to their security-based swap business.

Additionally, in accordance with Title VII, the Commission recently proposed, among other things, capital and margin requirements applicable to nonbank SBSDs and nonbank MSBSPs, and segregation requirements applicable to SBSDs.²⁵ The capital, margin, and segregation proposals that would be applicable to SBSDs were modeled on the capital, margin, and segregation requirements that are applicable to broker-dealers.²⁶ The broker-dealer capital, margin, segregation, recordkeeping, reporting, notification, and securities count requirements are known collectively as the broker-dealer financial responsibility rules.²⁷ The financial responsibility rules collectively establish a comprehensive regulatory program designed to promote the prudent operation of broker-dealers and the safeguarding of customer securities and funds held by broker-dealers. The recordkeeping, reporting, notification, and securities count requirements applicable to broker-dealers are an integral part of the financial responsibility rules as they are designed to provide transparency into the business activities of broker-dealers and to

²⁴ Although a broker-dealer SBSD would be able to offer customers a broader range of securities-based services than a bank SBSD, bank SBSDs are not expected to register as broker-dealers because of the regulatory burden associated with complying with the requirements applicable to all three types of entities.

²⁵ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

²⁶ Id. See also 17 CFR 240.15c3-1 (the broker-dealer capital rule); FINRA Rules 4210 through 4240 (certain broker-dealer margin rules); 17 CFR 240.15c3-3 (the broker-dealer segregation rule).

²⁷ See 17 CFR 240.3a40-1.

assist the Commission and other securities regulators in reviewing and monitoring compliance with the capital, margin, and segregation requirements. Similarly, the proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs along with the proposed capital, margin, and segregation requirements for these registrants are designed to establish a comprehensive financial responsibility program for SBSDs and MSBSPs. Like the broker-dealer rules, the proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs are designed to provide transparency into the business activities of SBSDs and MSBSPs and assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs.

While the proposed recordkeeping, reporting, notification, and securities count rules are modeled on the broker-dealer rules, stand-alone SBSDs and stand-alone MSBSPs will not engage in the same range of activities permitted of broker-dealers. For example, broker-dealers are permitted to act as dealers with respect to all types of securities, whereas stand-alone SBSDs would be permitted to act as dealers only with respect to security-based swaps and stand-alone MSBSPs would not be permitted to act as dealers with respect to any types of securities. Consequently, the proposed requirements in the new rules applicable to stand-alone SBSDs and stand-alone MSBSPs reflect these differences and are narrower in scope than those applicable to broker-dealer SBSDs and broker-dealer MSBSPs. Further, the proposed requirements applicable to bank SBSDs and bank MSBSPs are narrower in scope than those applicable to stand-alone SBSDs and stand-alone MSBSPs for three reasons. First, as noted above, the recordkeeping and reporting requirements for bank SBSDs and bank MSBSPs – unlike those for nonbank SBSDs

and nonbank MSBSPs – must be related to their business as an SBSD or MSBSP.²⁸ Second, as banks, these registrants are subject to existing recordkeeping and reporting requirements administered by the prudential regulators and therefore to avoid potentially duplicative or conflicting requirements, the Commission has proposed fewer requirements for these entities. Third, the prudential regulators – rather than the Commission – will administer the capital, margin, and other prudential requirements applicable to bank SBSDs and bank MSBSPs and, as noted above, one of the purposes of the proposed recordkeeping requirements is to assist the Commission in reviewing and monitoring compliance with the proposed capital and margin rules applicable to nonbank SBSDs and nonbank MSBSPs, which the Commission will administer.²⁹

The Commission recognizes that there may be alternative recordkeeping, reporting, notification, and securities count programs that could be used as a model to design a recordkeeping, reporting, notification, and securities count program for SBSDs and MSBSPs. Accordingly, in response to the requests for comment in this release, interested parties are encouraged to consider whether alternative approaches would be appropriate for SBSDs and MSBSPs generally as well as for each type of potential registrant – broker-dealer SBSD, broker-

²⁸ Compare 15 U.S.C. 78o-10(f)(1)(B)(i), with 15 U.S.C. 78o-10(f)(1)(B)(ii) and 15 U.S.C. 78q(a). As noted above, section 15F(f)(1)(B)(i) of the Exchange Act provides that each bank SBSD and bank MSBSP shall keep books and records of all activities related to the business as an SBSD or MSBSP in such form and manner and for such period as may be prescribed by the Commission by rule or regulation (emphasis added). See 15 U.S.C. 78o-10(f)(1)(B)(i). Whereas, section 15F(f)(1)(B)(ii) of the Exchange Act provides that each nonbank SBSD and nonbank MSBSP shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation. See 15 U.S.C. 78o-10(f)(1)(B)(ii). Further, section 17(a) of the Exchange Act provides that broker-dealers shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78q(a).

²⁹ Section 15F(e)(1)(A) of the Exchange Act provides that the prudential regulators shall prescribe capital and margin requirements for bank SBSDs and bank MSBSPs, and section 4s(e)(1)(A) of the CEA provides that the prudential regulators shall prescribe capital and margin requirements for swap dealers and major swap participants for which there is a prudential regulator (“bank swap dealers” and “bank swap participants”). See 15 U.S.C. 78o-10(e)(1)(A); 7 U.S.C. 6s(e)(1)(A). The prudential regulators have proposed capital and margin requirements for bank swap dealers, bank SBSDs, bank swap participants, and bank MSBSPs. See Margin and Capital Requirements for Covered Swap Entities, 76 FR 27564 (May 11, 2011).

dealer MSBSP, stand-alone SBSD, stand-alone MSBSP, bank SBSD, and bank MSBSP – taking into account the unique characteristics and activities of each type of potential registrant.

Some of the current rules that are proposed to be amended and the proposed new rules prescribe recordkeeping or reporting requirements based on requirements in other rules that have been proposed but not yet adopted. For example, Rules 17a-3 and 17a-4, as proposed to be amended, and proposed Rules 18a-5 and 18a-6 would directly or indirectly cross-reference requirements in proposed Rule 901 of Regulation SBSR and proposed Rules 15Fh-1 through 15Fh-6 and proposed Rule 15Fk-1.³⁰ Similarly, Rules 17a-3, 17a-4, 17a-5, and 17a-11, as proposed to be amended, and proposed Rules 18a-5, 18a-6, 18a-7, and 18a-8 cross-reference requirements in the proposed capital, margin, and segregation requirements for SBSDs and MSBSPs.³¹ If a cross-referenced rule is modified from the proposal when adopted, the Commission intends to make any necessary corresponding modifications to the rules proposed in this release when they are adopted.

Finally, the Commission also is proposing to add a capital charge provision to proposed Rule 18a-1.³² Proposed Rule 18a-1 would establish net capital requirements for stand-alone SBSDs and is modeled on Rule 15c3-1 under the Exchange Act (the broker-dealer net capital rule) (“Rule 15c3-1”).³³ The capital charge provision that would be added to proposed Rule 18a-1, which is modeled on a provision in Rule 15c3-1, was inadvertently omitted from proposed Rule 18a-1 when originally proposed. The Commission preliminarily believes that proposed Rule 18a-1 should include a provision that parallels the capital charge in Rule 15c3-1.

³⁰ See section II.A. of this release.

³¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

³² This proposal is discussed below in greater detail in section II.D.3. of this release.

³³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70217–70257.

The Commission staff consulted with staff from the prudential regulators and the CFTC in drafting the proposals discussed in this release.³⁴ In addition, the proposals of the CFTC were considered in developing the Commission's proposed recordkeeping, reporting, notification and securities count rules for SBSDs and MSBSPs.

Request for Comment

The Commission requests comment on the general approach that would require SBSDs and MSBSPs to comply with recordkeeping, reporting, notification, and securities count rules modeled on the broker-dealer recordkeeping, reporting, notification, and securities count rules. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Will the entities that register as nonbank SBSDs engage in a securities business with respect to security-based swaps that is similar to the securities business conducted by broker-dealers? If not, describe how the securities activities of nonbank SBSDs will differ from the securities activities of broker-dealers.
2. Will the entities that register as bank SBSDs engage in a securities business with respect to security-based swaps that is similar to the securities business conducted by broker-dealers? If not, describe how the securities activities of bank SBSDs will differ from the securities activities of broker-dealers.
3. How many broker-dealers will register as SBSDs? Describe the types of broker-dealers that will register as SBSDs and the types of activities these broker-dealers currently engage in? How many banks will register as SBSDs? Describe the types of banks that

³⁴ See Pub. L. 111-203, 712(a)(2). The CFTC has adopted recordkeeping and reporting rules for swap dealers and major swap participants. See Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128 (Apr. 3, 2012).

will register as SBSBs and the types of activities these banks currently engage in?

4. How many entities will register as MSBSBs? What types of entities? How many broker-dealers will register as MSBSBs? How many banks will register as MSBSBs?
5. Are there requirements in these proposed rules applicable to broker-dealer SBSBs and broker-dealer MSBSBs but currently not applicable to stand-alone SBSBs or stand-alone MSBSBs that should be applicable to standalone SBSBs or stand-alone MSBSBs, or vice versa?
6. Are there requirements in these proposed rules applicable to broker-dealer SBSBs and broker-dealer MSBSBs but currently not applicable to bank SBSBs or bank MSBSBs that should be applicable to bank SBSBs or bank MSBSBs, or vice versa?
7. Are there provisions in the rules that the CFTC adopted governing recordkeeping and reporting obligations of swap dealers and major swap participants that the Commission should consider incorporating into the recordkeeping and reporting requirements for SBSBs and MSBSBs? If so, please identify the specific provision and explain why the Commission should incorporate it.
8. In the release adopting a further definition of major security-based swap participant, the Commission stated that an entity's security-based swap positions in general would be attributed to a parent, other affiliate, or guarantor for purposes of the MSBSB analysis to the extent that the counterparties to those positions would have recourse to that other entity in connection with the position.³⁵ The Commission further stated that an entity that becomes an MSBSB by virtue of security-based swaps directly entered into by others must be responsible for compliance with all applicable requirements with respect to those

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See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR at 30689.

security-based swaps (and must be liable for failures to comply), but may delegate operational compliance with transaction-focused requirements to entities that directly are party to the transactions.³⁶ The Commission stated its preliminary belief that the same approach should apply in the cross-border context when the guarantor and the guaranteed persons are located in different jurisdictions.³⁷ The Commission preliminarily believes that certain of the recordkeeping requirements that would be applicable to MSBSPs under the proposed amendments are transaction-focused and, therefore, that an MSBSP may delegate operational compliance with them to the entities that are directly a party to the transaction.³⁸ For example, the Commission preliminarily believes that the proposed requirements discussed below in section II.A.2. of this release under which MSBSPs would need to make and keep current memoranda of proprietary orders, confirmations, accountholder information, and records relating to certain business conduct standards are transaction-focused. Similarly, the proposed requirements to retain communications relating to the MSBSP's "business as such" are transaction-focused. On the other hand, the Commission preliminarily believes that other recordkeeping requirements proposed for MSBSPs are entity-level requirements and, therefore an MSBSP would not be permitted to delegate operational compliance with respect to these requirements to other entities. For example, the Commission preliminarily believes that the proposed requirement that an MSBSP make and keep current a general ledger (or other records)

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Id.

³⁷

See Cross-Border Security-Based Swap Activities: Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968, 31034 (May 23, 2013).

³⁸

The Commission preliminarily believes that the proposed reporting and notification requirements that would be applicable to MSBSPs are not transaction-focused and, therefore, the MSBSP could not delegate operation compliance with respect to these requirements to other entities.

reflecting all assets and liabilities, income and expense, and capital accounts is an entity-level requirement. Commenters are asked to identify which of the recordkeeping requirements applicable to MSBSPs in proposed new Rules 18a-5 and 18a-6 that they believe are transaction-focused and to explain their reasons for identifying them as such. Commenters also are asked to identify any operational compliance challenges with respect to the proposed recordkeeping requirements raised by attributing guaranteed security-based swap positions to an MSBSP.

II. PROPOSED RULES AND RULE AMENDMENTS

A. Recordkeeping

1. Introduction

As discussed above in section I. of this release, section 15F(f)(2) of the Exchange Act provides that the Commission shall adopt rules governing recordkeeping for SBSDs and MSBSPs.³⁹ The Commission also has concurrent authority under section 17(a)(1) of the Exchange Act to prescribe recordkeeping requirements for broker-dealers.⁴⁰ Further, section 15F(f)(1)(B)(i) of the Exchange Act provides that each bank SBSD and bank MSBSP shall keep books and records of all activities related to its business as an SBSD or MSBSP in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁴¹ Section 15F(f)(1)(B)(ii) provides that each nonbank SBSD and nonbank MSBSP shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁴²

³⁹ See 15 U.S.C. 78o-10(f)(2).

⁴⁰ See 15 U.S.C. 78q(a)(1).

⁴¹ See 15 U.S.C. 78o-10(f)(1)(B)(i).

⁴² See 15 U.S.C. 78o-10(f)(1)(B)(ii).

Section 15F(g) of the Exchange Act prescribes statutory recordkeeping requirements applicable to SBSDs and MSBSPs and requires the Commission to adopt rules with respect to these statutory requirements.⁴³ In particular, section 15F(g)(1) provides that each registered SBSD and MSBSP shall maintain daily trading records of the security-based swaps of the registered SBSD and MSBSP and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as may be required by the Commission by rule or regulation.⁴⁴ Section 15F(g)(2) provides that the daily trading records shall include such information as the Commission shall require by rule or regulation.⁴⁵ Section 15F(g)(3) provides that each registered SBSD and MSBSP shall maintain daily trading records for each counterparty in a manner and form that is identifiable with each security-based swap transaction.⁴⁶ Section 15F(g)(4) provides that each registered SBSD and MSBSP shall maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions.⁴⁷ Finally, section 15F(g)(5) provides that the Commission shall adopt rules governing daily trading records for SBSDs and MSBSPs.⁴⁸

Section 15F(i)(1) of the Exchange Act provides that each registered SBSD and MSBSP shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation,

⁴³ See 15 U.S.C. 78o-10(g).

⁴⁴ See 15 U.S.C. 78o-10(g)(1).

⁴⁵ See 15 U.S.C. 78o-10(g)(2).

⁴⁶ See 15 U.S.C. 78o-10(g)(3).

⁴⁷ See 15 U.S.C. 78o-10(g)(4).

⁴⁸ See 15 U.S.C. 78o-10(g)(5).

and valuation of all security-based swaps.⁴⁹ Section 15F(i)(2) provides that the Commission shall adopt rules governing documentation standards for SBSDs and MSBSPs.⁵⁰

After considering the anticipated business activities of SBSDs and MSBSPs, the Commission is proposing to establish a recordkeeping program for these registrants under sections 15F and 17(a) of the Exchange Act that is modeled on the recordkeeping program for broker-dealers codified in Rules 17a-3 and 17a-4.⁵¹ Rules 17a-3 and 17a-4 specify requirements with respect to the records that a broker-dealer must make and keep current, as well as how long and, the manner in which, these records and other records relating to a broker-dealer's business must be maintained and preserved.⁵²

In particular, Rule 17a-3 requires a broker-dealer to make and keep current certain books and records.⁵³ The required records include, among other records: blotters containing an itemized daily record of all purchases and sales of securities; ledgers reflecting all assets and liabilities, income and expense, and capital accounts; a securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions; a memorandum of each brokerage order; a memorandum of each purchase or sale of a security for the account of the broker-dealer; and copies of confirmations.⁵⁴

⁴⁹ See 15 U.S.C. 78o-10(i)(1).

⁵⁰ See 15 U.S.C. 78o-10(i)(2). Pursuant to section 15F(i) of the Exchange Act, the Commission has proposed Rule 15Fi-1 that would prescribe standards related to timely and accurate confirmation and documentation of security-based swaps. See Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011).

⁵¹ See 17 CFR 240.17a-3; 17 CFR 240.17a-4.

⁵² See 17 CFR 240.17a-3; 17 CFR 240.17a-4.

⁵³ See 17 CFR 240.17a-3.

⁵⁴ Id. As noted above in section I. of this release, the Dodd-Frank Act amended the definition of security in section 3(a)(10) of the Exchange Act to include a security-based swap. See Pub. L. 111-203, 761(a)(2); 15 U.S.C. 78c(a)(10). Therefore, each reference in Rules 17a-3 and 17a-4 to a security includes a security-based swap. The Commission, however, has issued temporary exemptive relief excluding security-based swaps from the definition of security to the extent Commission rules did not otherwise apply specifically to security-based swaps prior to the amendment. See Order Granting Temporary Exemptions under the

Rule 17a-4 requires a broker-dealer to preserve additional records if the broker-dealer makes or receives the type of record.⁵⁵ The categories of records include, among other records, check books, bank statements, bills receivable or payable, communications relating to the broker-dealer's business as such, and written agreements.⁵⁶ The rule also establishes retention periods for all records required to be made and kept current under Rule 17a-3 and preserved under Rule 17a-4, and prescribes, among other things, how the records must be retained, including requirements for firms that preserve their records electronically.⁵⁷

The recordkeeping program codified in Rules 17a-3 and 17a-4 is designed, among other things, to promote the prudent operation of broker-dealers and assist the Commission, self-regulatory organizations ("SROs"), and state securities regulators in conducting effective examinations of broker-dealers.⁵⁸ As the Commission has stated,

In combination, Rules 17a-3 and 17a-4 require broker-dealers to create, and preserve in an accessible manner, a comprehensive record of each securities transaction they effect and of their securities business in general. These rules impose minimum recordkeeping requirements that are based on standards a prudent broker-dealer should follow in the normal course of business. The requirements are an integral part of the investor protection function of the Commission, and other securities regulators, in that the preserved records are the primary means of monitoring compliance

Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, 76 FR 39927.

⁵⁵ See 17 CFR 240.17a-4.

⁵⁶ Id.

⁵⁷ Id.

⁵⁸ See, e.g., See Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), 66 FR 22916; Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001) ("The Commission has required that broker-dealers create and maintain certain records so that, among other things, the Commission, [SROs], and State Securities Regulators . . . may conduct effective examinations of broker-dealers.") (footnote omitted).

with applicable securities laws, including antifraud provisions and financial responsibility standards.⁵⁹

Under the proposed recordkeeping program for SBSDs and MSBSPs, broker-dealer SBSDs and broker-dealer MSBSPs – as broker-dealers – would be subject to Rules 17a-3 and 17a-4.⁶⁰ The Commission is proposing amendments to these rules to account for the security-based swap and swap activities of broker-dealers, including broker-dealers registered as SBSDs and MSBSPs, as well as to implement the specific recordkeeping requirements mandated under the Dodd-Frank Act.⁶¹ Stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be subject to proposed Rules 18a-5 and 18a-6, which are modeled on Rules 17a-3 and 17a-4, respectively, as these rules are proposed to be amended.

Proposed Rules 18a-5 and 18a-6 would not include a parallel requirement for every requirement in Rules 17a-3 and 17a-4 because some of the requirements in Rules 17a-3 and 17a-4 relate to activities that are not expected or permitted of SBSDs and MSBSPs. Further, the proposed recordkeeping requirements that would be applicable to bank SBSDs and bank MSBSPs are more limited in scope because, as discussed above in section I. of this release: (1) the Commission's authority under section 15F(f)(1)(B)(i) of the Exchange Act is tied to activities related to the conduct of business as an SBSD or MSBSP; (2) bank SBSDs and bank MSBSPs are subject to recordkeeping requirements applicable to banks; and (3) the prudential regulators – rather than the Commission – are responsible for capital, margin, and other prudential requirements applicable to bank SBSDs and bank MSBSPs. For these reasons, the proposed recordkeeping requirements that would be applicable to bank SBSDs and bank

⁵⁹ See Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), 66 FR at 22917.

⁶⁰ See 17 CFR 240.17a-3; 17 CFR 240.17a-4.

⁶¹ As discussed in more detail below, the Commission also is proposing additional largely technical amendments to Rules 17a-3 and 17a-4.

MSBSPs are designed to be tailored more specifically to their security-based swap activities as an SBSD or an MSBSP.⁶²

2. Records to be Made and Kept Current

As discussed above, Rule 17a-3 requires a broker-dealer to make and keep current certain records.⁶³ The Commission is proposing to amend this rule to account for the security-based swap and swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs.⁶⁴ The Commission also is proposing additional largely technical amendments to Rule 17a-3.⁶⁵ With respect to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, the Commission is proposing new Rule 18a-5 – which is modeled on Rule 17a-3, as proposed to be amended – to require these registrants to make and keep current certain records.⁶⁶ For the reasons discussed above, proposed Rule 18a-5 does not include a parallel requirement for every requirement in Rule 17a-3.⁶⁷ In addition, paragraph (a) of proposed Rule 18a-5 contains

⁶² As discussed below in section II.B.2. of this release, the Commission is proposing that bank SBSDs and bank MSBSPs be subject to a limited reporting program of general information about their overall financial condition based on discrete elements of the reporting program the prudential regulators have established for banks.

⁶³ See 17 CFR 240.17a-3.

⁶⁴ Broker-dealer SBSDs and broker-dealer MSBSPs would be required to make and keep current all the records required of broker-dealers under Rule 17a-3, as proposed to be amended, plus the additional records required specifically of an SBSD or MSBSP.

⁶⁵ The proposed technical amendments are discussed below in section II.A.2.b. of this release.

⁶⁶ See proposed Rule 18a-5.

⁶⁷ The Commission is not proposing to include in proposed Rule 18a-5 requirements that would parallel requirements in paragraphs (a)(4), (a)(13), (a)(14), (a)(15), and (a)(16) of Rule 17a-3. These paragraphs require broker-dealers to make and keep current records with respect to activities that stand-alone SBSDs and stand-alone MSBSPs would not be expected or permitted to engage in or would not relate to a bank's business as an SBSD or MSBSP, or relate to rules that would not apply to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs. Further, the Commission is not proposing to include in proposed Rule 18a-5 requirements that would parallel requirements in paragraphs (a)(17), (a)(18), (a)(19), and (a)(20) of Rule 17a-3. These requirements are designed to enhance the ability of regulators, particularly State securities regulators, to conduct effective and efficient sales practice examinations. See Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR at 55818. By adopting these requirements, the Commission enabled States to adopt and enforce similar rules on the State level under the National Securities Market Improvement Act of 1996. See National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (1996). As discussed

one set of recordkeeping requirements applicable to stand-alone SBSDs and stand-alone MSBSPs and paragraph (b) of proposed Rule 18a-5 contains a separate set of recordkeeping requirements applicable to bank SBSDs and bank MSBSPs that are more limited in scope.⁶⁸

As discussed above, section 15F(g) of the Exchange Act provides, among other things, that each registered SBSD and MSBSP shall maintain: (1) daily trading records of the security-based swaps of the registered SBSD and MSBSP; (2) daily trading records for each counterparty in a manner and form that is identifiable with each security-based swap transaction; and (3) a complete audit trail for conducting comprehensive and accurate trade reconstructions.⁶⁹ Further, section 15F(g)(2) provides that the daily trading records shall include such information as the Commission shall require by rule or regulation.⁷⁰ To implement section 15F(g) of the Exchange Act, Rule 17a-3, as proposed to be amended, and proposed Rule 18a-5 include provisions that, among other things, are designed to require information that would facilitate a comprehensive and accurate trade reconstruction for each security-based swap transaction.

In this regard, the amendments to Rule 17a-3 and proposed Rule 18a-5 would require broker-dealers, SBSDs, and MSBSPs to make and keep current daily trading records,⁷¹ ledger accounts,⁷² a securities record,⁷³ memoranda of brokerage orders,⁷⁴ and/or memoranda of

below, the Commission has proposed external business conduct rules for SBSDs and MSBSPs and, as discussed below, the Commission is proposing recordkeeping requirements to support examinations for compliance with these proposed external business conduct rules.

⁶⁸ Compare paragraph (a), with paragraph (b) of proposed new Rule 18a-5.

⁶⁹ See 15 U.S.C. 78o-10(g)(1), (3), and (4).

⁷⁰ See 15 U.S.C. 78o-10(g)(2).

⁷¹ See paragraph (a)(1) of Rule 17a-3, as proposed to be amended; paragraphs (a)(1) and (b)(1) of proposed Rule 18a-5.

⁷² See paragraph (a)(3) of Rule 17a-3, as proposed to be amended; paragraphs (a)(3) and (b)(2) of proposed Rule 18a-5.

⁷³ See paragraph (a)(5)(ii) of Rule 17a-3, as proposed to be amended; paragraphs (a)(4)(ii) and (b)(3)(ii) of proposed Rule 18a-5.

proprietary trades⁷⁵ with respect to security-based swap activity. The Commission has proposed Rule 901 of Regulation SBSR, which would require market participants, including broker-dealers, SBSDs, and MSBSPs, to report certain data elements to security-based swap data repositories.⁷⁶

The following data elements that would be required to be reported under proposed Rule 901 also would need to be documented in the daily trading records, ledger accounts, memoranda of brokerage orders, and/or memoranda of proprietary trades of security-based swap transactions required under the proposed amendments to Rule 17a-3 and proposed Rule 18a-5: (1) the type of security-based swap;⁷⁷ (2) the reference security, index, or obligor;⁷⁸ (3) the date and time of execution;⁷⁹ (4) the effective date;⁸⁰ (5) the termination or maturity date;⁸¹ (6) the notional amount;⁸² (7) the unique transaction identifier;⁸³ and (8) the unique counterparty identifier.⁸⁴

⁷⁴ See paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended; paragraph (b)(4) of proposed Rule 18a-5.

⁷⁵ See paragraph (a)(7)(ii) of Rule 17a-3, as proposed to be amended; paragraphs (a)(5) and (b)(5) of proposed Rule 18a-5.

⁷⁶ See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Securities Exchange Act Release No. 63346 (Nov. 19, 2010), 75 FR 75207 (Dec. 2, 2010). See also Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 FR 30968 (re-proposing certain aspects of Regulation SBSR).

⁷⁷ Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 FR at 75213 (discussing the requirement in paragraph (c)(1) of proposed Rule 901 to report the asset class of the security-based swap).

⁷⁸ See id. at 75214 (discussing the requirement in paragraph (c)(2) of proposed Rule 901 to report the specific assets or issuers of any securities upon which the security-based swap is based).

⁷⁹ See id. at 75213 (discussing the requirement in paragraph (c)(4) of proposed Rule 901 to report the time and date of execution of the security-based swap).

⁸⁰ See id. at 75214 (discussing the requirement in paragraph (c)(5) of proposed Rule 901 to report the effective date of the security-based swap).

⁸¹ See id. at 75214 (discussing the requirement in paragraph (c)(6) of proposed Rule 901 to report the scheduled termination date of the security-based swap).

⁸² See id. at 75214 (discussing the requirement in paragraph (c)(3) of proposed Rule 901 to report the notional amount of the security-based swap).

The following data elements that would be required to be reported under proposed Rule 901 would also need to be documented in the securities record of security-based swap transactions required under the proposed amendments to Rule 17a-3 and proposed Rule 18a-5: (1) the reference security, index, or obligor;⁸⁵ (2) the unique transaction identifier;⁸⁶ (3) the unique counterparty identifier;⁸⁷ (4) whether the security-based swap is cleared or not cleared;⁸⁸ and (5) if cleared, identification of the clearing agency where the security-based swap is cleared.⁸⁹ In addition, the securities record for security-based swaps would parallel the securities record for securities by requiring a record of whether the security-based swap is a “long” or “short” position.⁹⁰

Where a data element that would need to be documented in the daily trading records of security-based swap transactions under the proposed amendments to Rule 17a-3 or proposed Rule 18a-5 is substantively the same as a data element that would need to be reported under proposed Rule 901, the Commission preliminarily believes that the type of information that would need to be documented in the daily trading records could be the same data element

⁸³ See *id.* at 75221 (discussing the requirement in paragraph (g) of proposed Rule 901 to report the unique transaction identifier for the security-based swap).

⁸⁴ See *id.* at 75217–75218, 75221–75222 (discussing the requirement in paragraph (d) of proposed Rule 901 to report the unique identifier of the counterparty to the security-swap transaction).

⁸⁵ See *id.* at 75214 (discussing the requirement in paragraph (c)(2) of proposed Rule 901 to report the specific assets or issuers of any securities upon which the security-based swap is based).

⁸⁶ See *id.* at 75221 (discussing the requirement in paragraph (g) of proposed Rule 901 to report the unique transaction identifier for the security-based swap).

⁸⁷ See *id.* at 75217–75218, 75221–75222 (discussing the requirement in paragraph (d)(1)(i) of proposed Rule 901 to report the participant ID of the counterparty to the security-swap transaction).

⁸⁸ See *id.* at 75214 (discussing the requirement in paragraph (c)(9) of proposed Rule 901 to report the whether or not the security-based swap will be cleared by a clearing agency).

⁸⁹ See *id.* at 75218 (discussing the requirement in paragraph (d)(1)(vi) of proposed Rule 901 to report the name of the clearing agency if the security-based swap will be cleared).

⁹⁰ Compare 17 CFR 240.17a-3(a)(5), with paragraph (a)(5)(ii) of Rule 17a-3, as proposed to be amended, and paragraphs (a)(4)(ii) and (b)(3)(ii) of proposed Rule 18a-5.

reported under proposed Rule 901.⁹¹

a. Amendments to Rule 17a-3 and Proposed Rule 18a-5

Undesignated Introductory Paragraph

Rule 17a-3, as proposed to be amended, would contain an undesignated introductory paragraph explaining that the rule applies to a broker-dealer, including a broker-dealer dually registered with the Commission as an SBSD or MSBSP.⁹² The note further explains that an SBSD or MSBSP that is not dually registered as a broker-dealer (*i.e.*, a stand-alone SBSD, stand-alone MSBSP, bank SBSD, or bank MSBSP) is subject to the books and records requirements under proposed Rule 18a-5.⁹³

Similarly, proposed Rule 18a-5 would contain an undesignated introductory paragraph explaining that the rule applies to an SBSD or an MSBSP that is not dually registered as a broker-dealer.⁹⁴ The note further explains that a broker-dealer that is dually registered as an SBSD or MSBSP is subject to the books and records requirements under Rule 17a-3.⁹⁵

Trade Blotters

Paragraph (a)(1) of Rule 17a-3 requires broker-dealers to make and keep current trade blotters (or other records of original entry) containing an itemized daily record of all transactions in securities, all receipts and deliveries of securities, all receipts and disbursements of cash, and all other debits and credits.⁹⁶ The Commission is proposing to amend paragraph (a)(1) of Rule

⁹¹ Proposed Rule 901 may be modified when adopted, which could include changing or eliminating certain data elements required to be reported under the rule. Any such modifications to the data elements could change the Commission's preliminary view on the comparability of the information to be recorded in the daily trading records and the information to be reported pursuant to proposed Rule 901.

⁹² See undesignated introductory paragraph of Rule 17a-3, as proposed to be amended.

⁹³ Id.

⁹⁴ See undesignated introductory paragraph of proposed Rule 18a-5.

⁹⁵ Id.

⁹⁶ See 17 CFR 240.17a-3(a)(1).

17a-3 to require that the blotters specifically account for security-based swaps, and proposing to include parallel blotter requirements in paragraphs (a)(1) and (b)(1) of proposed Rule 18a-5 that are modeled on paragraph (a)(1) of Rule 17a-3, as proposed to be amended.⁹⁷ In particular, paragraph (a)(1) of Rule 17a-3, as proposed to be amended, would require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current blotters containing an itemized daily record of all transactions in securities, including security-based swaps, all receipts and deliveries of securities, all receipts and disbursements of cash, and all other debits and credits.⁹⁸ In order to document the attributes of security-based swaps, the proposed amendments also would require that such records show the contract price of the security-based swap, and include for each purchase and sale, the following information: (1) the type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.⁹⁹

Paragraph (a)(1) of proposed Rule 18a-5 mirrors paragraph (a)(1) of Rule 17a-3, as proposed to be amended, and therefore, stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same types of blotters as broker-dealers.¹⁰⁰ Paragraph (b)(1) of proposed Rule 18a-5 similarly would require bank SBSDs and bank MSBSPs to make and keep current the same types of blotters but only with respect to their security-based swap activities.¹⁰¹

⁹⁷ See paragraph (a)(1) of Rule 17a-3, as proposed to be amended; paragraphs (a)(1) and (b)(1) of proposed Rule 18a-5.

⁹⁸ See paragraph (a)(1) of Rule 17a-3, as proposed to be amended.

⁹⁹ See *id.*

¹⁰⁰ Compare paragraph (a)(1) of Rule 17a-3, as proposed to be amended, with paragraph (a)(1) of proposed Rule 18a-5.

¹⁰¹ See paragraph (b)(1) of proposed Rule 18a-5.

General Ledger

Paragraph (a)(2) of Rule 17a-3 requires broker-dealers to make and keep current ledgers (or other records) reflecting all assets and liabilities, income and expense, and capital accounts.¹⁰² These records reflect the overall financial condition of the broker-dealer and in the Commission's view can incorporate security-based swap activities without the need for a clarifying amendment. Because the overall financial condition of stand-alone SBSDs and stand-alone MSBSPs is a matter of regulatory concern for the Commission, the Commission is proposing to include a parallel provision in paragraph (a)(2) of proposed Rule 18a-5 that mirrors paragraph (a)(2) of Rule 17a-3.¹⁰³ Consequently, stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same types of general ledgers.¹⁰⁴

Ledgers for Customer and Non-Customer Accounts

Paragraph (a)(3) of Rule 17a-3 requires broker-dealers to make and keep current certain ledger accounts (or other records) relating to securities and commodities transactions in customer and non-customer cash and margin accounts.¹⁰⁵ The Commission is proposing to amend paragraph (a)(3) of Rule 17a-3 to require that the ledgers (or other records) specifically account for security-based swaps, and to include parallel ledger requirements in paragraphs (a) and (b) of proposed Rule 18a-5 that are modeled on paragraph (a)(3) of Rule 17a-3, as proposed to be amended.¹⁰⁶ In particular, paragraph (a)(3) of Rule 17a-3 would be amended to include a requirement that broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs,

¹⁰² See 17 CFR 240.17a-3(a)(2).

¹⁰³ Compare 17 CFR 240.17a-3(a)(2), with paragraph (a)(2) of proposed Rule 18a-5.

¹⁰⁴ See paragraph (a)(2) of proposed Rule 18a-5.

¹⁰⁵ See 17 CFR 240.17a-3(a)(3).

¹⁰⁶ See paragraph (a)(3) of Rule 17a-3, as proposed to be amended; paragraphs (a)(3) and (b)(2) of proposed Rule 18a-5.

make and keep current ledger accounts (or other records) itemizing separately as to each security-based swap: (1) the type of security-based swap; (2) the reference security, index, or obligor; (3) date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.¹⁰⁷

Paragraph (a)(3) of Rule 18a-5 is modeled on paragraph (a)(3) of Rule 17a-3, as proposed to be amended, and therefore, stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same types of ledgers (or other records).¹⁰⁸ Unlike paragraph (a)(3) of Rule 17a-3, paragraph (a)(3) of proposed Rule 18a-5 would not refer to “cash and margin accounts” as these types of accounts involve activities that would not be permitted of stand-alone SBSDs and stand-alone MSBSPs because they are not registered as broker-dealers.¹⁰⁹ Paragraph (b)(2) of proposed Rule 18a-5 similarly would require bank SBSDs and bank MSBSPs to make and keep current ledger accounts (or other records) relating to securities and commodity transactions but only with respect to their security-based swap customers and non-customers.¹¹⁰

¹⁰⁷ See paragraph (a)(3) of Rule 17a-3, as proposed to be amended.

¹⁰⁸ Compare paragraph (a)(3) of Rule 17a-3, as proposed to be amended, with paragraph (a)(3) of proposed Rule 18a-5.

¹⁰⁹ See *id.*

¹¹⁰ See paragraph (b)(2) of proposed Rule 18a-5. The Commission has proposed a definition of security-based swap customer for the purposes of proposed Rule 18a-4. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70278. Proposed Rule 18a-4 – which is modeled on Rule 15c3-3 – would establish segregation requirements for SBSDs with respect to their security-based swap customers. *Id.* at 70274–70288. The term security-based swap customer would be defined in proposed Rule 18a-4 to mean any person from whom or on whose behalf the SBSD has received or acquired or holds funds or other property for the account of the person with respect to a cleared or non-cleared security-based swap transaction. *Id.* at 70278. The definition would exclude a person to the extent that person has a claim for funds or other property which by contract, agreement or understanding, or by operation of law, is part of the capital of the SBSD or is subordinated to all claims of security-based swap customers of the SBSD. *Id.*

Stock Record

Paragraph (a)(5) of Rule 17a-3 requires broker-dealers to make and keep current a securities record (also referred to as a “stock record”).¹¹¹ This is a record of the broker-dealer’s custody and movement of securities. The “long” side of the record accounts for the broker-dealer’s responsibility as a custodian of securities and shows, for example, the securities the firm has received from customers and securities owned by the broker-dealer. The “short” side of the record shows where the securities are located such as at a securities depository.

The Commission is proposing to amend paragraph (a)(5) of Rule 17a-3 to require that the securities record specifically account for security-based swaps, and to include parallel securities record requirements in paragraphs (a) and (b) of proposed Rule 18a-5 that are modeled on paragraph (a)(5) of Rule 17a-3, as proposed to be amended.¹¹² Paragraph (a)(5) of Rule 17a-3, as proposed to be amended, would contain separate provisions: one for securities other than security-based swaps and one for security-based swaps.¹¹³ Specifically, paragraph (a)(5)(i) would apply to securities other than security-based swaps and largely mirror the current text of paragraph (a)(5) of Rule 17a-3.¹¹⁴ Paragraph (a)(5)(ii) would apply to security-based swaps.¹¹⁵ This paragraph would require a broker-dealer, including a broker-dealer SBSD and broker-dealer MSBSP, to make and keep current a securities record or ledger reflecting separately for each security-based swap: (1) the reference security, index, or obligor; (2) the unique transaction identifier; (3) the unique counterparty identifier; (4) whether it is a “long” or “short” position in

¹¹¹ See 17 CFR 240.17a-3(a)(5).

¹¹² See paragraph (a)(5) of Rule 17a-3, as proposed to be amended; paragraphs (a)(4) and (b)(3) of proposed Rule 18a-5.

¹¹³ See paragraphs (a)(5)(i)–(ii) of Rule 17a-3, as proposed to be amended.

¹¹⁴ Compare 17 CFR 240.17a-3(a)(5), with paragraph (a)(5)(i) of Rule 17a-3, as proposed to be amended.

¹¹⁵ See paragraph (a)(5)(ii) of Rule 17a-3, as proposed to be amended.

the security-based swap; (5) whether the security-based swap is cleared or not cleared; and (6) if cleared, identification of the clearing agency where the security-based swap is cleared.¹¹⁶

Paragraph (a)(4) of proposed Rule 18a-5 mirrors paragraph (a)(5) of Rule 17a-3 as proposed to be amended, and therefore, stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same type of securities record.¹¹⁷ Paragraph (b)(3) of proposed Rule 18a-5 similarly would require bank SBSDs and bank MSBSPs to make and keep current a securities record of the firm's securities positions but only with respect to positions related to their business as an SBSD or MSBSP.¹¹⁸

Memoranda of Brokerage Orders

Paragraph (a)(6) of Rule 17a-3 requires broker-dealers to make and keep current a memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security. The memorandum must show the terms and conditions of each brokerage order.¹¹⁹ The Commission is proposing to amend paragraph (a)(6) of Rule 17a-3 to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current a memorandum of each brokerage order, given or received for the purchase or sale of a security-based swap.¹²⁰ The Commission is not proposing to include a parallel provision in paragraph (a) of proposed Rule 18a-5 applicable to stand-alone SBSDs and stand-alone MSBSPs because these registrants would not be permitted to engage in the business of effecting brokerage

¹¹⁶ See id.

¹¹⁷ Compare paragraph (a)(5) of Rule 17a-3, as proposed to be amended, with paragraph (a)(4) of proposed Rule 18a-5.

¹¹⁸ See paragraph (b)(3) of proposed Rule 18a-5.

¹¹⁹ See 17 CFR 240.17a-3(a)(6).

¹²⁰ See paragraph (a)(6) of Rule 17a-3, as proposed to be amended.

orders in security-based swaps without registering as a broker-dealer or a bank.¹²¹ The Commission is proposing to include a parallel provision that would be applicable to bank SBSDs and bank MSBSPs in paragraph (b) of proposed Rule 18a-5 that is modeled on paragraph (a)(6) of Rule 17a-3, as proposed to be amended.¹²²

Paragraph (a)(6) of Rule 17a-3, as proposed to be amended, would contain separate provisions: one for brokerage orders involving securities other than security-based swaps and one for brokerage orders involving security-based swaps.¹²³ Specifically, proposed paragraphs (a)(6)(i)(A) and (B) would apply to securities other than security-based swaps and largely mirror the current text of paragraph (a)(6) of Rule 17a-3.¹²⁴ Proposed paragraph (a)(6)(ii) would apply to brokerage orders involving security-based swaps.¹²⁵ This paragraph would require a broker-

¹²¹ Generally, persons engaged in brokerage activities are required to register as brokers under section 15(b) of the Exchange Act. See 15 U.S.C. 78o(b). Banks are permitted to engage in certain limited securities brokerage activities. Specifically, section 3(a)(4) of the Exchange Act provides eleven exceptions to broker-dealer registration for banks. See 15 U.S.C. 78c(a)(4). In addition, the Commission and the Federal Reserve promulgated joint rules establishing further exemptions permitting banks to engage in certain securities brokerage activities without registering as a broker-dealer. See Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks, Exchange Act Release No. 56501 (Sept. 24, 2007), 72 FR 56514 (Oct. 3, 2007); 17 CFR 247.100-781. These exceptions and exemptions permit a bank to act as a broker or agent in securities transactions provided they satisfy certain conditions. Section 716 of the Dodd-Frank Act ("Swap Push-Out Provision") generally prohibits providing certain types of federal assistance, including FDIC insurance, to SBSDs and MSBSPs with respect to any swap, security-based swap, or other activity of the SBSD or MSBSP. See Pub. L. 111-203, 716. The Swap Push-Out Provision excludes MSBSPs that are insured depository institutions. See Pub. L. 111-203, 716(b)(2)(B). Further, SBSDs that are insured depository institutions are permitted to engage in certain swap and security-based swap activities under certain conditions and still qualify for federal assistance. See Pub. L. 111-203, 716(d) through (f). Thus, a bank SBSD or bank MSBSP may act as a broker or agent in a security-based swap transaction. In such instances, the brokerage order record requirements of paragraph (b)(4) of proposed Rule 18a-5 would apply.

¹²² See paragraph (b)(4) of proposed Rule 18a-5.

¹²³ See paragraph (a)(6) of Rule 17a-3, as proposed to be amended. Rule 17a-3 currently contains paragraphs (a)(6)(i) and (ii). See 17 CFR 240.17a-3(a)(6)(i) and (ii). Under the amendments, paragraph (a)(6)(i) of Rule 17a-3 would be redesignated as paragraph (a)(6)(i)(A) and paragraph (a)(6)(ii) would be redesignated as paragraph (a)(6)(i)(B). The new requirement to make and keep current a memorandum of each security-based swap brokerage order would be contained in paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended.

¹²⁴ Compare 17 CFR 240.17a-3(a)(6)(i) and (ii), with paragraphs (a)(6)(i)(A) and (B) of Rule 17a-3, as proposed to be amended.

¹²⁵ See paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended.

dealer, including a broker-dealer SBSB and broker-dealer MSBSP, to make and keep current a memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security-based swap, whether executed or unexecuted. The memorandum would need to include information that is similar to the information currently required under Rule 17a-3 for brokerage orders.¹²⁶ In addition, to account for the attributes of security-based swaps, the memorandum would need to include: (1) the type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.¹²⁷

Paragraph (b)(4) of proposed Rule 18a-5 similarly would require bank SBSBs and bank MSBSPs to document key terms of brokerage orders but only with respect to security-based swaps.¹²⁸ Consequently, proposed paragraph (b)(4) would not contain a provision for securities that are not security-based swaps.¹²⁹ Instead, the entire paragraph mirrors paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended, which, as discussed above, relates solely to security-based swaps.¹³⁰

Memoranda of Proprietary Orders

Paragraph (a)(7) of Rule 17a-3 requires broker-dealers to make and keep current a memorandum of each purchase and sale for the account of the broker-dealer.¹³¹ Generally, paragraph (a)(7) of Rule 17a-3 requires broker-dealers to document the terms of securities

¹²⁶ Compare 17 CFR 240.17a-3(a)(6)(i), with paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended.

¹²⁷ See paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended.

¹²⁸ See paragraph (b)(4) of proposed Rule 18a-5.

¹²⁹ See *id.*

¹³⁰ Compare paragraph (a)(6)(ii) of Rule 17a-3, as proposed to be amended, with paragraph (b)(4) of proposed Rule 18a-5.

¹³¹ See 17 CFR 240.17a-3(a)(7).

transactions where they are acting as a dealer or otherwise trading for their own account. The Commission is proposing to amend paragraph (a)(7) of Rule 17a-3 to require the terms of security-based swap transactions to be documented, and to include parallel memorandum requirements in paragraphs (a) and (b) of proposed Rule 18a-5 that are modeled on paragraph (a)(7) of Rule 17a-3, as proposed to be amended.¹³² Paragraph (a)(7) of Rule 17a-3, as proposed to be amended, would contain two separate provisions: one for securities other than security-based swaps and one for security-based swaps.¹³³ Specifically, proposed paragraph (a)(7)(i) would apply to securities other than security-based swaps and largely would mirror the current text of paragraph (a)(7) of Rule 17a-3.¹³⁴ Paragraph (a)(7)(ii) would apply to security-based swaps.¹³⁵ This paragraph would require broker-dealers, including broker-dealer SBSBs and broker-dealer MSBSBs, to make and keep current a memorandum documenting each security-based swap transaction for the account of the broker-dealer. The memorandum would need to include certain information regarding the purchase or sale of a security-based swap for the account of the broker-dealer that is similar to the information currently required under paragraph (a)(7) of Rule 17a-3.¹³⁶ In addition, to account for the attributes of security-based swaps, the memorandum would need to include: (1) the type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the

¹³² See paragraph (a)(7) of Rule 17a-3, as proposed to be amended; paragraphs (a)(5) and (b)(5) of proposed Rule 18a-5.

¹³³ See paragraphs (a)(7)(i) and (ii) of Rule 17a-3, as proposed to be amended.

¹³⁴ Compare 17 CFR 240.17a-3(a)(7), with paragraph (a)(7)(i) of Rule 17a-3, as proposed to be amended.

¹³⁵ See paragraph (a)(7)(ii) of Rule 17a-3, as proposed to be amended.

¹³⁶ Compare 17 CFR 240.17a-3(a)(7), with paragraph (a)(7)(ii) of Rule 17a-3, as proposed to be amended.

termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.¹³⁷

Paragraph (a)(5) of proposed Rule 18a-5 would require stand-alone SBSDs and stand-alone MSBSPs to make memoranda of proprietary transactions but only with respect to security-based swaps.¹³⁸ This is because a stand-alone SBSD or a stand-alone MSBSP would need to be registered as a broker-dealer (and therefore would be subject to Rule 17a-3) (or, in certain circumstances, a bank) to deal in securities other than security-based swaps. Paragraph (b)(5) of proposed Rule 18a-5 would require bank SBSDs and bank MSBSPs to make memoranda of proprietary transactions but also only with respect to security-based swaps.¹³⁹

Confirmations

Paragraph (a)(8) of Rule 17a-3 requires broker-dealers to make and keep current copies of confirmations of purchases and sales of securities.¹⁴⁰ The Commission is proposing to amend paragraph (a)(8) to require that confirmations of security-based swaps be documented, and to include analogous confirmation requirements in paragraphs (a) and (b) of proposed Rule 18a-5 that are modeled on paragraph (a)(8) of Rule 17a-3, as proposed to be amended.¹⁴¹ Paragraph (a)(8) of Rule 17a-3, as proposed to be amended, would contain separate provisions: one for securities other than security-based swaps and one for security-based swaps.¹⁴² Specifically, proposed paragraph (a)(8)(i) would apply to confirmations of securities transactions other than

¹³⁷ See paragraph (a)(7)(ii) of Rule 17a-3, as proposed to be amended.

¹³⁸ See paragraph (a)(5) of proposed Rule 18a-5.

¹³⁹ See paragraph (b)(5) of proposed Rule 18a-5.

¹⁴⁰ See 17 CFR 240.17a-3(a)(8). See also 17 CFR 240.10b-10 (a requirement that broker-dealers disclose specified information to customers at or before completion of a securities transaction).

¹⁴¹ See paragraph (a)(8) of Rule 17a-3, as proposed to be amended; paragraphs (a)(6) and (b)(6) of proposed Rule 18a-5.

¹⁴² See paragraphs (a)(8)(i) and (a)(8)(ii) of Rule 17a-3, as proposed to be amended.

security-based swap transactions and largely mirror the current text of paragraph (a)(8) of Rule 17a-3.¹⁴³ Proposed paragraph (a)(8)(ii) would apply to confirmations of security-based swap transactions.¹⁴⁴ As discussed above, section 15F(i)(2) of the Exchange Act provides that the Commission shall adopt rules governing documentation standards for SBSDs and MSBSPs.¹⁴⁵ Pursuant to section 15F(i)(2), the Commission proposed Rule 15Fi-1 under the Exchange Act (“Rule 15Fi-1”) to prescribe standards related to timely and accurate confirmation and documentation of security-based swaps.¹⁴⁶ Under this proposed rule, SBSDs and MSBSPs would be required to acknowledge and, thereafter, verify security-based swap transactions.¹⁴⁷ Consequently, paragraph (a)(8)(ii) of Rule 17a-3 would require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current copies of the security-based swap trade acknowledgments and verifications made pursuant to proposed Rule 15Fi-1.¹⁴⁸

Paragraph (a)(6) of proposed Rule 18a-5 would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current copies of confirmations of all purchases or sales of securities, which would include securities other than security-based swaps.¹⁴⁹ Paragraph (a)(6) also would specify that, for security-based swap transactions, stand-alone SBSDs and stand-alone MSBSPs would need to make and keep current copies of the security-based swap trade acknowledgments and verifications made pursuant to proposed Rule 15Fi-1.¹⁵⁰ Paragraph (b)(6) would require bank SBSDs and bank MSBSPs to make and keep current copies of all

¹⁴³ Compare paragraph (a)(8)(i) of Rule 17a-3, as proposed to be amended, with 17 CFR 240.17a-3(a)(8).

¹⁴⁴ See paragraph (a)(8)(ii) of Rule 17a-3, as proposed to be amended.

¹⁴⁵ See 15 U.S.C. 78o-10(i)(2).

¹⁴⁶ See Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 FR 3859.

¹⁴⁷ Id.

¹⁴⁸ See paragraph (a)(8)(ii) of Rule 17a-3, as proposed to be amended.

¹⁴⁹ See paragraph (a)(6) of proposed Rule 18a-5.

¹⁵⁰ Id.

confirmations of purchases and sales of securities but only if related to their business as an SBSD or MSBSP.¹⁵¹ This would require a bank SBSD or bank MSBSP to make and keep current copies of confirmations relating to transactions in securities, other than security-based swaps, if the transaction was related to their business as an SBSD or MSBSP. For example, this requirement would apply if the bank SBSD or bank MSBSP entered into a transaction in the security underlying a security-based swap to hedge the risk of the security-based swap. Paragraph (b)(6) also would specify that, for security-based swap transactions, bank SBSDs and bank MSBSPs would need to make and keep current copies of the security-based swap trade acknowledgments and verifications made pursuant to proposed Rule 15Fi-1.¹⁵²

Accountholder Information

Paragraph (a)(9) of Rule 17a-3 requires broker-dealers to make and keep current certain information with respect to each securities accountholder.¹⁵³ The Commission is proposing to amend paragraph (a)(9) to require certain information with respect to security-based swap accountholders, and to include similar requirements in paragraphs (a) and (b) of proposed Rule 18a-5.¹⁵⁴ The amendments to Rule 17a-3 would add a new paragraph (a)(9)(iv).¹⁵⁵ This paragraph would require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current, in the case of a security-based swap account: (1) a record of the unique counterparty identifier of the accountholder; (2) the name and address of accountholder; and (3) the signature of each person authorized to transact business in the

¹⁵¹ See paragraph (b)(6) of proposed Rule 18a-5.

¹⁵² Id.

¹⁵³ See 17 CFR 240.17a-3(a)(9).

¹⁵⁴ See paragraph (a)(9) of Rule 17a-3, as proposed to be amended; paragraphs (a)(7) and (b)(7) of proposed Rule 18a-5.

¹⁵⁵ See paragraph (a)(9)(iv) of Rule 17a-3, as proposed to be amended.

security-based swap account.¹⁵⁶ Consequently, in the case of accounts of legal entities (e.g., a corporation, partnership, or trust), signatures would be required from persons authorized by the entity to transact business in the account.

Paragraphs (a)(7) and (b)(7) of proposed Rule 18a-5 mirror paragraph (a)(9)(iv) of Rule 17a-3, as proposed to be amended.¹⁵⁷ Consequently, stand-alone SBSs, stand-alone MSBSPs, bank SBSs, and bank MSBSPs would be required to make and keep current the same types of records with respect to security-based swap accountholders.

Options Positions

Paragraph (a)(10) of Rule 17a-3 requires broker-dealers to make and keep current a record of all options positions.¹⁵⁸ The Commission is not proposing to amend paragraph (a)(10) of Rule 17a-3 to account for security-based swaps.¹⁵⁹ In addition, because the records required under this paragraph are not specific to security-based swaps, the Commission is not proposing to include an analogous provision in paragraph (b) applicable to bank SBSs and bank MSBSPs. However, in order to facilitate the monitoring of the financial condition of stand-alone SBSs and stand-alone MSBSPs, the Commission is proposing to include a parallel provision in paragraph (a)(8) of proposed Rule 18a-5 applicable to stand-alone SBSs and stand-alone MSBSPs.¹⁶⁰ Consequently, under the proposed rule, these registrants would be required to make

¹⁵⁶

Id.

¹⁵⁷

Compare paragraph (a)(9)(iv) of Rule 17a-3, as proposed to be amended, with paragraphs (a)(7) and (b)(7) of proposed Rule 18a-5.

¹⁵⁸

See 17 CFR 240.17a-3(a)(10).

¹⁵⁹

As discussed below in section II.A.2.b. of this release, the Commission is proposing technical amendments to paragraph (a)(10) of Rule 17a-3.

¹⁶⁰

See paragraph (a)(8) of proposed Rule 18a-5. The second sentence of paragraph (a)(10) of Rule 17a-3 applies only to a special class of broker-dealers that limit their activities to dealing in OTC derivatives ("OTC derivatives dealers"). See 17 CFR 240.17a-3(a)(10); OTC Derivatives Dealers, Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 59362 (Nov. 3, 1998). Consequently, it is not included in paragraph (a)(8) of proposed Rule 18a-5.

and keep current the same type of records broker-dealers must keep: a record of all puts, calls, spreads, straddles, and other options in which the stand-alone SBSD or stand-alone MSBSP has any direct or indirect interest or which the stand-alone SBSD or stand-alone MSBSP has granted or guaranteed, containing, at a minimum, an identification of the security and the number of units involved.¹⁶¹

Trial Balances and Computation of Net Capital

Paragraph (a)(11) of Rule 17a-3 requires broker-dealers to make and keep current a record of the proof of money balances of all ledger accounts in the form of trial balances and certain records relating to the computation of aggregate indebtedness and net capital under Rule 15c3-1.¹⁶² The Commission is not proposing to amend paragraph (a)(11) to account for security-based swaps because the impact of security-based swaps on those computations is reflected in the amendments to the capital rules that have been proposed by the Commission to apply to broker-dealer SBSDs and stand-alone SBSDs.¹⁶³ In addition, because the records required under the rule are not specific to security-based swaps and because bank SBSDs and bank MSBSPs will be subject to capital requirements administered by the prudential regulators, the Commission is not proposing to include a parallel provision in paragraph (b) of proposed Rule 18a-5 applicable to these types of registrants.

The Commission, however, is proposing to include a parallel requirement in paragraph (a)(9) of proposed Rule 18a-5 applicable to stand-alone SBSDs and stand-alone MSBSPs because the types of records required under paragraph (a)(11) of Rule 17a-3 would facilitate the

¹⁶¹ See paragraph (a)(8) of proposed Rule 18a-5.

¹⁶² See 17 CFR 240.17a-3(a)(11).

¹⁶³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70217-70257. As discussed below in section II.A.2.b. of this release, the Commission is proposing technical amendments to paragraph (a)(11) of Rule 17a-3.

review and monitoring of the financial condition and regulatory capital of stand-alone SBSDs and stand-alone MSBSPs. As noted above, the Commission will administer the capital rules applicable to stand-alone SBSDs and stand-alone MSBSPs.¹⁶⁴ Under Paragraph (a)(9) of proposed Rule 18a-5, stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current similar records to those required under paragraph (a)(11) of Rule 17a-3 but in relation to the proposed capital rules for these entities: (1) proposed Rule 18a-1 in the case of stand-alone SBSDs; and (2) proposed Rule 18a-2 in the case of stand-alone MSBSPs.¹⁶⁵ Specifically, paragraph (a)(9) would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current a record of the proof of money balances of all ledger accounts in the form of trial balances, and a record as of the trial balance date of the computation of net capital pursuant to proposed Rule 18a-1 or the computation of tangible net worth pursuant to proposed Rule 18a-2. The trial balances and computations would need to be prepared at least once a month in relation to the financial reporting on Form SBS that the Commission is proposing for these registrants under proposed Rule 18a-7.¹⁶⁶

Associated Persons

Paragraph (a)(12) of Rule 17a-3 requires broker-dealers to make and keep current records of information about associated persons of the broker-dealer.¹⁶⁷ This requirement will apply to broker-dealer SBSDs and broker-dealer MSBSPs and, therefore, the Commission is not

¹⁶⁴ See paragraph (a)(9) of proposed Rule 18a-5.

¹⁶⁵ See *id.* See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213 (proposing Rule 18a-1 applicable to stand-alone SBSDs and Rule 18a-2 applicable to nonbank MSBSPs that would establish capital standards for these registrants).

¹⁶⁶ The proposed requirements to file Form SBS are discussed below in section II.B.2. of this release.

¹⁶⁷ See 17 CFR 240.17a-3(a)(12).

proposing to amend paragraph (a)(12) to account for security-based swaps.¹⁶⁸ The Commission, however, is proposing to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a-5.¹⁶⁹ Consequently, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be required to make and keep current a questionnaire or application for employment for each associated person, which must include the associated person's identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things.¹⁷⁰

Further, the Commission is proposing to amend the definition of associated person in Rule 17a-3 to include in the definition a person associated with an SBSD or MSBSP as defined under section 3(a)(70) of the Exchange Act.¹⁷¹ Section 761 of the Dodd-Frank Act added section 3(a)(70) to the Exchange Act to define the terms person associated with a security-based swap dealer or major security-based swap participant and associated person of a security-based swap dealer or major security-based swap participant.¹⁷² Paragraph (c)(1) of proposed Rule 18a-5 similarly would provide that the term associated person means for the purposes of proposed Rule 18a-5 a person associated with an SBSD or MSBSP as defined under section 3(a)(70) of the Exchange Act.¹⁷³ Paragraph (c)(2) of proposed Rule 18a-5 would limit the definition of the term

¹⁶⁸ As discussed below in section II.A.2.b. of this release, the Commission is proposing technical amendments to paragraph (a)(12) of Rule 17a-3.

¹⁶⁹ Compare 17 CFR 240.17a-3(a)(12), with paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

¹⁷⁰ See paragraph (a)(10) and (b)(8) of proposed Rule 18a-5. Unlike paragraph (a)(12) of Rule 17a-3, paragraphs (a)(10) and (b)(8) do not permit applications of registration made by the associated person to an SRO to satisfy the requirements because the Dodd-Frank Act did not establish SROs for SBSDs and MSBSPs. Compare 17 CFR 240.17a-3(a)(12), with paragraph (a)(10) and (b)(8) of proposed Rule 18a-5.

¹⁷¹ See paragraph (f)(4) of Rule 17a-3, as proposed to be amended; 15 U.S.C. 78c(a)(70).

¹⁷² See Pub. L. 111-203, 761; 15 U.S.C. 78c(a)(70).

¹⁷³ See paragraph (c)(1) of proposed Rule 18a-5.

associated person for purposes of the rule and with respect to bank SBSBs and bank MSBSBs to persons whose activities relate to the conduct of business as an SBSB or MSBSB.¹⁷⁴

Liquidity Stress Test

Funding liquidity risk has been defined as the risk that a firm will not be able to efficiently meet both expected and unexpected current and future cash flow and collateral needs without adversely impacting either the daily operations or the financial condition of the firm.¹⁷⁵ The financial crisis of 2008 demonstrated that the funding liquidity risk management practices of certain individual financial institutions were not sufficient to handle a liquidity stress event of that magnitude.¹⁷⁶ In particular, it has been observed that the stress tests utilized at the time by financial institutions had weaknesses¹⁷⁷ and the amount of contingent liquidity they maintained to replace external sources of funding was insufficient to cover the institutions' liquidity needs.¹⁷⁸

¹⁷⁴ See paragraph (c)(2) of proposed Rule 18a-5.

¹⁷⁵ See Joint Forum, Bank for International Settlements, The management of liquidity risk in financial groups, 1 n.1 (May 2006), available at <http://www.bis.org/publ/joint16.pdf>. See also Basel Committee on Banking Supervision, Bank for International Settlements, Principles for Sound Liquidity Risk Management and Supervision, n.2 (Sept. 2008), available at <http://www.bis.org/publ/bcbs144.pdf> ("Funding liquidity risk is the risk that the firm will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the firm. Market liquidity risk is the risk that a firm cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption."); Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 55432 (Mar. 9, 2007), 72 FR 12862, 12870 n.72 (Mar. 19, 2007) ("Liquidity risk includes the risk that a firm will not be able to unwind or hedge a position or meet cash demands as they become due."); Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, Federal Reserve, 77 FR 594 (Jan. 5, 2012) (proposing a rule to require certain large financial institutions to conduct liquidity stress testing at least monthly).

¹⁷⁶ See Senior Supervisors Group, Risk Management Lessons from the Global Bank Crisis of 2008, (Oct. 21, 2009), available at <http://www.sec.gov/news/press/2009/report102109.pdf>.

¹⁷⁷ Id. at 14 ("Market conditions and the deteriorating financial state of firms exposed weaknesses in firms' approaches to liquidity stress testing, particularly with respect to secured borrowing and contingent funding needs. These deteriorating conditions underscored the need for greater consideration of the overlap between systemic and firm-specific events and longer time horizons, and the connection between stress tests and business-as-usual liquidity management.").

¹⁷⁸ Id. at 15 ("Interviewed firms typically calculated and maintained a measurable funding cushion, such as 'months of coverage,' which is conceptually similar to rating agencies' twelve-month liquidity alternatives analyses. Some institutions were required to maintain a liquidity cushion that could withstand the loss of

The Commission has proposed that certain broker-dealers, including broker-dealer SBSDs, and certain stand-alone SBSDs be subject to liquidity stress test requirements.¹⁷⁹ In particular, the Commission has proposed amendments to Rule 15c3-1 that would establish liquidity stress test requirements for broker-dealers that have been approved to use internal models to calculate market and credit risk charges when computing net capital (“ANC broker-dealers”), which would include broker-dealer SBSDs approved to use internal models for this purpose (“ANC broker-dealer SBSDs”).¹⁸⁰ The Commission has proposed identical liquidity stress test requirements for stand-alone SBSDs that are approved to use internal models to calculate market and credit risk charges when computing net capital under proposed Rule 18a-1 (“stand-alone ANC SBSDs”).¹⁸¹ Under the proposed liquidity stress test requirements, ANC

unsecured funding for one year. Many institutions found that this metric did not capture important elements of stress that the organizations faced, such as the loss of secured funding and demands for collateral to support clearing and settlement activity and to mitigate the risks of accepting novations.”) (emphasis in the original).

¹⁷⁹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252–70254 (proposing funding liquidity stress test requirements).

¹⁸⁰ Id. Rule 15c3-1 requires that a broker-dealer perform two calculations: (1) a computation of the minimum amount of net capital the firm must maintain; and (2) a computation of the amount of net capital the firm is maintaining. See 17 CFR 240.15c3-1. In computing net capital, a broker-dealer must, among other things, make certain adjustments to net worth such as deducting illiquid assets and taking other capital charges and adding qualifying subordinated loans. See 17 CFR 240.15c3-1(c)(2)(i) through (xiii). The amount remaining after these deductions is defined as tentative net capital. See 17 CFR 240.15c3-1(c)(15). The final step in computing net capital is to take prescribed percentage deductions (“standardized haircuts”) from the mark-to-market value of the proprietary positions (e.g., securities, money market instruments, and commodities) that are included in tentative net capital. See 17 CFR 240.15c3-1(c)(2)(vi). The standardized haircuts are designed to account for the market risk inherent in these positions and to create a buffer of liquidity to protect against other risks associated with the securities business. ANC broker-dealers and OTC derivatives dealers are permitted, with Commission approval, to calculate net capital using internal models as the basis for taking market risk and credit risk charges in lieu of the standardized haircuts for classes of positions for which they have been approved to use models. See 17 CFR 240.15c3-1(a)(5) and (a)(7); 17 CFR 240.15c3-1e; 17 CFR 240.15c3-1f. Broker-dealer SBSDs that seek to use internal models to calculate market and credit risk charges when computing net capital would need to be approved to operate as ANC broker-dealers. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70217–70256. Theoretically, a broker-dealer MSBSP could be authorized to operate as an ANC broker-dealer, in which case it would be subject to the liquidity stress test requirement.

¹⁸¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252–70254.

broker-dealers and stand-alone ANC SBSBs would be required, among other things, to conduct a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for thirty consecutive days and to establish a written contingency funding plan.

To promote compliance with these proposed requirements and the risk management practices of ANC broker-dealers, the Commission is proposing to amend Rule 17a-3 to add a requirement that ANC broker-dealers, including ANC broker-dealer SBSBs, make and keep current a report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under the proposed amendments to Rule 15c3-1.¹⁸² The Commission is not proposing to include a similar provision in paragraph (b) of proposed Rule 18a-5 applicable to bank SBSBs because these registrants would not be subject to the Commission's capital requirements, including the funding liquidity stress test requirement. However, the Commission is proposing to include a parallel provision applicable to stand-alone SBSBs in paragraph (a) of proposed Rule 18a-5 that is modeled on the requirement that would be added to Rule 17a-3, as proposed to be amended.¹⁸³ Consequently, stand-alone ANC SBSBs would be required to make and keep current a report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan.¹⁸⁴

Account Equity and Margin Calculations under Proposed Rule 18a-3

The Commission has proposed Rule 18a-3, which would establish margin requirements with respect to non-cleared security-based swaps applicable to nonbank SBSBs and nonbank

¹⁸² See paragraph (a)(24) of Rule 17a-3, as proposed to be amended.

¹⁸³ Compare paragraph (a)(24) of Rule 17a-3, as proposed to be amended, with paragraph (a)(11) of proposed Rule 18a-5.

¹⁸⁴ See paragraph (a)(11) of proposed Rule 18a-5.

MSBSPs.¹⁸⁵ Proposed Rule 18a-3 would require nonbank SBSDs, among other things, to perform two daily calculations for each security-based swap account: the amount of equity in the account and a margin amount for the account.¹⁸⁶ Nonbank MSBSPs would be required to calculate only the equity in the account.¹⁸⁷ The Commission is proposing to require that nonbank SBSDs and nonbank MSBSPs make and keep current a record of the daily calculations that would be required under Rule 18a-3 by amending Rule 17a-3 and including a parallel provision in paragraph (a) of proposed Rule 18a-5.¹⁸⁸ The objective of these requirements is to promote compliance with proposed Rule 18a-3, to require records to assist nonbank SBSDs and nonbank MSBSPs in managing their credit risk to security-based swap counterparties, and to assist Commission examiners in reviewing compliance with those rule requirements.¹⁸⁹

Possession or Control Requirements under Proposed Rule 18a-4

Rule 15c3-3 under the Exchange Act ("Rule 15c3-3") requires a broker-dealer that carries customer securities or cash (a "carrying broker-dealer") to maintain physical possession or control over customers' fully paid and excess margin securities.¹⁹⁰ Physical possession or

¹⁸⁵ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70257-70274.

¹⁸⁶ Id. at 70260-70262.

¹⁸⁷ Id. at 70262-70263.

¹⁸⁸ See paragraph (a)(25) of Rule 17a-3, as proposed to be amended; paragraph (a)(12) of proposed Rule 18a-5. See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70257-70274.

¹⁸⁹ As discussed above in section I. of this release, section 15F(e)(1)(A) of the Exchange Act provides that the prudential regulators shall prescribe capital and margin requirements for bank SBSDs and bank MSBSPs. See 15 U.S.C. 78o-10(e)(1)(A).

¹⁹⁰ See 17 CFR 240.15c3-3(d). The term fully paid securities includes all securities carried for the account of a customer in a special cash account as defined in Regulation T promulgated by the Federal Reserve, as well as margin equity securities within the meaning of Regulation T which are carried for the account of a customer in a general account or any special account under Regulation T during any period when section 8 of Regulation T (12 CFR 220.8) specifies that margin equity securities shall have no loan value in a general account or special convertible debt security account, and all such margin equity securities in such account if they are fully paid; provided, however, that the term fully paid securities shall not apply to any securities

control means the carrying broker-dealer must hold these securities in one of several locations specified in Rule 15c3-3 and free of liens or any other interest that could be exercised by a third party to secure an obligation of the broker-dealer.¹⁹¹ Permissible locations include a bank, as defined in section 3(a)(6) of the Exchange Act, and a clearing agency.¹⁹² The Commission has proposed Rule 18a-4 to establish security-based swap customer protection requirements that are modeled on the requirements in Rule 15c3-3.¹⁹³ Paragraph (b)(1) of proposed Rule 18a-4 would require an SBSB to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.¹⁹⁴ The

which are purchased in transactions for which the customer has not made full payment. See 17 CFR 240.15c3-3(a)(3). The term margin securities means those securities carried for the account of a customer in a general account as defined in Regulation T, as well as securities carried in any special account other than the securities referred to in paragraph (a)(3) of Rule 15c3-3. See 17 CFR 240.15c3-3(a)(4). The term excess margin securities means those securities referred to in paragraph (a)(4) of Rule 15c3-3 carried for the account of a customer having a market value in excess of 140% of the total of the debit balances in the customer's account or accounts encompassed by paragraph (a)(4) of Rule 15c3-3 which the broker-dealer identifies as not constituting margin securities. See 17 CFR 240.15c3-3(a)(5).

¹⁹¹ See 17 CFR 240.15c3-3(c). Customer securities held by the carrying broker-dealer are not assets of the firm. Rather, the carrying broker-dealer holds them in a custodial capacity and the possession or control requirement is designed to ensure that the carrying broker-dealer treats them in a manner that allows for their prompt return.

¹⁹² Id.

¹⁹³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70274-70288. As broker-dealers, broker-dealer SBSBs and broker-dealer MSBSPs would be subject to Rule 15c3-3 with respect to customers that are not security-based swap customers and, in the case of a broker-dealer SBSB, Rule 18a-4 with respect to security-based swap customers. Id. at 70277 ("A broker-dealer SBSB would need to treat security-based swap accounts separately from other securities accounts and, consequently, would need to perform separate possession or control and reserve account computations for security-based swap accounts and other securities accounts. The former would be subject to the possession or control and reserve account requirements in proposed new Rule 18a-4 and the latter would continue to be subject to the analogous requirements in Rule 15c3-3. This would keep separate the segregated customer property related to security-based swaps from customer property related to other securities, including property of retail securities customers.").

¹⁹⁴ Under proposed Rule 18a-4, the term excess securities collateral would be defined to mean securities and money market instruments carried for the account of a security-based swap customer that have a market value in excess of the current exposure of the SBSB to the customer, excluding, under certain specified conditions, securities or money market instruments used to meet a margin requirement of a registered security-based swap clearing agency or of another SBSB. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70279. As noted above, the term security-based swap customer would be defined to mean any person from whom or on whose behalf the SBSB has received or acquired or

physical possession or control requirement of paragraph (b)(1) of proposed Rule 18a-4 would prohibit SBSDs from lending or hypothecating excess securities collateral of security-based swap customers, and would require SBSDs to either physically hold excess securities collateral or to custody the collateral in a satisfactory control location.¹⁹⁵ Paragraph (b)(2) of proposed new Rule 18a-4 would identify five satisfactory control locations for excess securities collateral.¹⁹⁶ Paragraph (b)(3) of Rule 18a-4 would require that each business day the SBSD must determine from its books and records the quantity of excess securities collateral that the firm had in its possession or control as of the close of the previous business day and the quantity of excess securities collateral the firm did not have in its possession or control on that day.¹⁹⁷ The paragraph would provide further that the SBSD must take steps to retrieve excess securities collateral from certain specifically identified non-control locations if securities and money market instruments of the same issue and class are at these locations.¹⁹⁸

The Commission is proposing to require that all SBSDs make and keep current a record of compliance with the possession or control requirement under proposed Rule 18a-4 by amending Rule 17a-3 to add this new requirement and including parallel requirements in paragraphs (a) and (b) of proposed Rule 18a-5.¹⁹⁹ Consequently, this new recordkeeping

holds funds or other property for the account of the person with respect to a cleared or non-cleared security-based swap transaction. Id. at 70278. The definition would exclude a person to the extent that person has a claim for funds or other property which by contract, agreement or understanding, or by operation of law, is part of the capital of the SBSD or is subordinated to all claims of security-based swap customers of the SBSD. Id.

¹⁹⁵ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70278.

¹⁹⁶ Id. at 70280–70281.

¹⁹⁷ Id. at 70281–70282.

¹⁹⁸ Id. at 70281.

¹⁹⁹ See paragraph (a)(26) of Rule 17a-3, as proposed to be amended; paragraphs (a)(13) and (b)(9) of proposed Rule 18a-5.

requirement would apply to broker-dealer SBSBs, stand-alone SBSBs, and bank SBSBs.²⁰⁰ The records required under this proposal would need to document that each business day the firm took the steps required under paragraph (b) of proposed Rule 18a-3 described above. The objective of this new recordkeeping requirement would be to promote compliance with the possession or control requirements of proposed Rule 18a-4 and to assist Commission examiners in reviewing compliance.

Customer Reserve Requirements under Proposed Rule 18a-4

Rule 15c3-3 requires a carrying broker-dealer to maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers.²⁰¹ The amount of net cash owed to customers is computed pursuant to a formula set forth in Exhibit A to Rule 15c3-3.²⁰² The Commission has proposed a parallel requirement in proposed Rule 18a-4.²⁰³ Proposed Rule 18a-4 would require an SBSB, among other things, to maintain a security-based swap customer reserve account at an unaffiliated bank separate from any other bank account of the SBSB.²⁰⁴ Further, it would provide that the SBSB must at all times maintain in the security-based swap customer reserve account cash and/or qualified securities in amounts computed daily in accordance with Exhibit A to proposed Rule 18a-4.²⁰⁵

²⁰⁰ See id.

²⁰¹ See 17 CFR 240.15c3-3(e). The term qualified security is defined in Rule 15c3-3 to mean a security issued by the U.S. or a security in respect of which the principal and interest are guaranteed by the U.S. See 17 CFR 240.15c3-3(a)(6).

²⁰² See 17 CFR 240.15c3-3a.

²⁰³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70282-70287. As noted above, broker-dealer SBSBs and broker-dealer MSBSPs would be subject to Rule 15c3-3 with respect to customers that are not security-based swap customers and, in the case of a broker-dealer SBSB, Rule 18a-4 with respect to security-based swap customers.

²⁰⁴ Id.

²⁰⁵ Id.

The Commission is proposing to require that all types of SBSDs make and keep current a record of their reserve computations under proposed Rule 18a-4 by amending Rule 17a-3 to add the requirement and to include parallel requirements in paragraphs (a) and (b) of proposed Rule 18a-5.²⁰⁶ The objective of this requirement would be to promote SBSD compliance with the customer reserve computation requirement and to assist Commission examiners in reviewing compliance.

Unverified Transactions

Prudent practice requires counterparties to promptly confirm the terms of executed OTC derivatives transactions.²⁰⁷ Consequently, the Commission proposed Rule 15Fi-1 to promote the efficient operation of the security-based swap market and to facilitate market participants' management of the risk of trading in security-based swaps.²⁰⁸ Among other things, proposed Rule 15Fi-1 would require broker-dealers, SBSDs, and MSBSPs to provide trade acknowledgments containing the details of a security-based swap transaction within prescribed timeframes and to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of the trade acknowledgments.²⁰⁹

To promote compliance with proposed Rule 15Fi-1 and the risk management practices of broker-dealers, SBSDs, and MSBSPs, the Commission is proposing to amend Rule 17a-3 to add a requirement to make a record of each security-based swap trade acknowledgment that is not verified within five business days of execution and to include parallel provisions in paragraphs

²⁰⁶ See paragraph (a)(27) of Rule 17a-3, as proposed to be amended; paragraphs (a)(14) and (b)(10) of proposed Rule 18a-5.

²⁰⁷ See Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 FR at 3860.

²⁰⁸ Id. at 3861.

²⁰⁹ Id. at 3861-3867.

(a) and (b) of proposed Rule 18a-5.²¹⁰ Consequently, all types of SBSDs and MSBSPs would be required to make and keep current these records. While the Commission did not prescribe a timeframe in proposed Rule 15Fi-1 within which security-based swap trade acknowledgements would need to be verified, the proposed rule does require procedures reasonably designed to obtain “prompt verification.”²¹¹ The proposed requirement to make a record of security-based swap trade acknowledgements that are not verified within five business days is not intended to establish a maximum timeframe within which verification should be obtained under proposed Rule 15Fi-1. The five business day threshold is designed to require SBSDs and MSBSPs to make a record of transactions that have gone unverified for a significant length of time.²¹² This could indicate a deficiency in the controls established to verify transactions or the existence of a disagreement with the counterparty as to the terms of the transaction.

Records Relating to Business Conduct Standards

The Commission has proposed Rules 15Fh-1 through 15Fh-6 and Rule 15Fk-1 to establish external business conduct requirements for SBSDs and MSBSPs.²¹³ As currently proposed, the requirements in these rules, would address (among other things):

- Verification of the status of the counterparty;
- Certain disclosures related to the daily mark and its calculation;
- Disclosures regarding material incentives, conflicts of interest, material risks, and characteristics of the security-based swap, and certain clearing rights;

²¹⁰ See paragraph (a)(28) of Rule 17a-3, as proposed to be amended; paragraphs (a)(15) and (b)(11) of proposed Rule 18a-5.

²¹¹ See Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 FR at 3866.

²¹² Proposed Rule 15Fi-1 requires registered entities to verify the terms of security-based swap transactions with the counterparty. However, a party that is not a registered entity is not required to verify a security-based swap transaction. Registered entities must have procedures to verify security-based swap transactions with unregistered entities. *Id.* at 3866-3867.

²¹³ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42396 (July 18, 2011).

- Certain “know your counterparty” and suitability obligations for SBSDs;
- Supervisory requirements including written policies and procedures;
- Certain requirements regarding interactions with special entities;
- Provisions intended to prevent SBSDs and independent representatives of special entities from engaging in certain “pay to play” activities; and
- Certain minimum requirements relating to chief compliance officers.

To promote compliance with these external business conduct standards, the Commission is proposing amendments to Rule 17a-3 and to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a-5.²¹⁴ First, the Commission is proposing that all types of SBSDs be required to make and keep current a record that demonstrates their compliance with proposed Rule 15Fh-6 (regarding political contributions by certain security-based swap dealers).²¹⁵ Second, the Commission is proposing that all types of SBSDs and MSBSPs be required to make and keep current a record that demonstrates their compliance with proposed Rules 15Fh-1 through 15Fh-5 and Rule 15Fk-1, as applicable.²¹⁶ These paragraphs would require covered firms to keep supporting documents evidencing their compliance with the business conduct standards; a mere attestation of compliance would not be sufficient. To the

²¹⁴ See paragraphs (a)(29) and (a)(30) of Rule 17a-3, as proposed to be amended; paragraphs (a)(16), (a)(17), (b)(12) and (b)(13) of proposed Rule 18a-5.

²¹⁵ See paragraph (a)(29) of Rule 17a-3, as proposed to be amended; paragraphs (a)(16) and (b)(12) of proposed Rule 18a-5.

²¹⁶ See paragraph (a)(30) of Rule 17a-3, as proposed to be amended; paragraphs (a)(17) and (b)(13) of proposed Rule 18a-5. Paragraph (b)(2) of proposed Rule 15Fk-1 would require chief compliance officers of SBSDs and MSBSPs to establish, maintain and review written policies and procedures reasonably designed to achieve compliance with section 15F of the Act and the rules and regulations thereunder, by the SBSDs and MSBSPs.

extent that the rules require providing or receiving written disclosures or written representations, the SBSD or MSBSP would be required to retain a copy of such disclosure or representation.²¹⁷

Request for Comment

The Commission generally requests comment on the proposals to require broker-dealers, SBSDs, and MSBSPs to make and keep current certain types of records. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the provisions in Rule 17a-3 that would be included as parallel provisions in paragraph (a) of proposed Rule 18a-5 appropriate for stand-alone SBSDs and stand-alone MSBSPs? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them. Are there provisions in Rule 17a-3 that are not being included as parallel provisions in paragraph (a) of proposed Rule 18a-5 that would be appropriate for stand-alone SBSDs and stand-alone MSBSPs? If so, explain why.
2. Are the provisions in Rule 17a-3 that would be included as parallel provisions in paragraph (b) of proposed Rule 18a-5 appropriate for bank SBSDs and bank MSBSPs? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them. Are there provisions in Rule 17a-3 that are not being included as parallel provisions in paragraph (b) of proposed Rule 18a-5 that would be appropriate for bank SBSDs and bank MSBSPs? If so, explain why.
3. Are the recordkeeping provisions that would be added to paragraph (a) of Rule 17a-3 appropriate for broker-dealers, including broker-dealer SBSDs and broker-dealer

²¹⁷ See paragraph (a)(14) of Rule 17a-4, as proposed to be amended; paragraphs (b)(1)(xii) and (b)(2)(vii) of proposed Rule 18a-6.

MSBSPs? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them.

4. Paragraph (a)(23) of Rule 17a-3, as recently amended, requires certain broker-dealers to make and keep current a record documenting the broker-dealer's credit, market, and liquidity risk management controls.²¹⁸ Should an analogous requirement be added to Rule 18a-5? Explain why or why not.
5. Is the five business day time frame for triggering the unverified transaction record requirement an appropriate length of time? Should the time frame be shorter (e.g., three days)? Should the time frame be longer (e.g., seven or ten days)?
6. How do the types of records that would need to be made under Rule 17a-3, as proposed to be amended, and proposed Rule 18a-5 align with the types of records that an FCM or a swap dealer would be required to make? Commenters are asked to identify and explain requirements that they believe would result in a dually registered entity (e.g., a broker-dealer/FCM or an SBSB/swap dealer) needing to make two sets of records that address the same matter or information as opposed to a single record that includes information that would satisfy requirements of both recordkeeping programs.
7. As noted above, certain data elements that would need to be documented under the proposed amendments to Rule 17a-3 or proposed Rule 18a-5 are substantively the same as certain data elements that would need to be reported under proposed Rule 901. Should any additional data elements required to be reported under proposed Rule 901 be required to be recorded in the daily trading records under the proposed amendments to Rule 17a-3 or proposed Rule 18a-5? Are any of the data elements that would be required to be

²¹⁸ See Financial Responsibility Rules for Broker-Dealers, 78 FR at 51907.

recorded in the daily trading records not appropriate for such records? If so, identify them and explain why. Are there any data elements that should be required to be recorded even though they are not required by proposed Rule 901? If so, identify them and explain why.

8. Can the data elements with respect to security-based swaps that would be required to be recorded in the daily trading records under the proposed amendments to Rule 17a-3 and proposed Rule 18a-5 be stored in, and retrieved from, a single database in order to generate the various types of records that would need to be made (e.g., ledger accounts, securities record, memoranda of brokerage orders, and memoranda of proprietary trades)? If not, explain why not. If so, describe any system changes that would need to be made and identify, estimate, and quantify the burden(s) associated with such system changes.
9. Paragraph (a)(29) of Rule 17a-3, as proposed to be amended, and paragraphs (a)(16) and (b)(12) of proposed Rule 18a-5 require broker-dealer SBSs, stand-alone SBSs, and bank SBSs, respectively, to make and keep a record that demonstrates they complied with the business conduct standards required under proposed Rule 15Fh-6. Should these paragraphs also require these entities to make and keep specified records pertaining to proposed Rule 15Fh-6 to help in evaluating compliance? Explain why or why not. For example, based on the provisions of proposed Rule 15Fh-6, should the following rule text be used in paragraphs (a)(29) and (a)(30) of Rule 17a-3, as proposed to be amended (and in paragraphs (a)(16) and (a)(17), and paragraphs (b)(12) and (b)(13) of proposed Rule 18a-5):

“(29) A record with respect to § 240.15Fh-6 [as proposed at 76 FR 42396, July 18, 2011] containing the following information:

(i) The names, titles, and business and residence addresses of all covered associates of the broker or dealer;

(ii) All municipal entities to which a broker or dealer has provided services in connection with the solicitation or entry into security-based swaps or trading strategies involving security-based swaps in the past five years, but not before six months prior to the effective date of § 240.15Fh-6 [as proposed at 76 FR 42396, July 18, 2011]; and

(iii) In chronological order, all direct or indirect contributions made by the broker or dealer or any of its covered associates (including contributions made up to six months prior to becoming a covered associate) to an official of a municipal entity, or direct or indirect payments to a political party of a state or political subdivision thereof, or to a political action committee, including:

(A) The name and title of each contributor;

(B) The name and title, including the city, county, state, or other political subdivision, of each recipient of a contribution or payment;

(C) Whether the contributor was entitled to vote for the recipient at the time of the contribution;

(D) The amount and date of each contribution and payment; and

(E) Whether any such contribution was the subject of the exception for certain returned contributions pursuant to § 240.15Fh-6(d) or (e) [as proposed at 76 FR 42396, July 18, 2011]; and

(iv) The name and business address of each municipal advisor to whom the broker or dealer provides or agrees to provide, directly or indirectly, payment to solicit a municipal entity for services on its behalf; and, for purposes of this paragraph, the terms

contribution, covered associates, municipal entity, official of municipal entity, payment and solicit will have the same meaning as set forth in § 240.15Fh-6(a) [as proposed at 76 FR 42396, July 18, 2011].

(30) A record that demonstrates the broker or dealer has complied with the business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-6 and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011].”?

If this rule text should be used, explain why. If this rule text should not be used, explain why not. Is there alternative rule text that should be used? If so, explain why alternative rule text should be used?

b. Additional Proposed Amendments to Rule 17a-3

The Commission is proposing several amendments to Rule 17a-3 to eliminate obsolete text, improve readability, and modernize terminology. Reference is made throughout Rule 17a-3 to “members” of a national securities exchange as a distinct class of registrant in addition to “brokers” and “dealers”. The Commission is proposing to remove these references to “members” given that the rule applies to brokers-dealers, which would include members of a national securities exchange that are brokers-dealers.²¹⁹ The Commission is proposing a second global change that would replace the word “shall” in the rule with the word “must” or “will” where appropriate.²²⁰ Similarly, when defining terms, the Commission is proposing to replace

²¹⁹ The proposed amendments would delete the word “member” from the title and from the following paragraphs of Rule 17a-3, as proposed to be amended: (a), (a)(3), (a)(5)(i), (a)(6)(i), (a)(7)(i), (a)(8)(i), (a)(9), (a)(10), (a)(11), (a)(12), (a)(17)(i), (a)(18), (a)(19), (a)(20), (a)(22), (b), (e), (f)(2), and (f)(4). See Rule 17a-3, as proposed to be amended.

²²⁰ The proposed amendments would replace the word “shall” with the word “must” or “will” in the following paragraphs of Rule 17a-3, as proposed to be amended: (a), (a)(6)(i)(A), (a)(7)(i), (a)(10), (a)(11), (a)(12)(i), (a)(16)(ii), (a)(17)(i), (a)(18)(i), (a)(19)(i), (b), (d), (e), and (f)(4). See Rule 17a-3, as proposed to be amended.

the phrase “shall mean” with the word “means”.²²¹ The Commission also proposes to make certain stylistic, corrective, and punctuation amendments to improve the rule’s readability.²²²

The Commission is proposing to simplify the text in paragraph (a) of Rule 17a-3 to state that Rule 17a-3 applies to “every broker or dealer”, since the undesignated introductory paragraph already provides sufficient detail as to the types of registrants to which the rule applies.²²³

In recognition of the fact that broker-dealers may execute orders for non-customers, the Commission is proposing to amend paragraph (a)(6) of Rule 17a-3 to specify that a broker-dealer must maintain a copy of the customer’s or non-customer’s subscription agreement.

The Commission is proposing to restructure paragraph (a)(11) of Rule 17a-3 to eliminate paragraphs (a)(11)(i)-(ii).²²⁴ Under these amendments, the text of paragraph (a)(11)(i) of Rule 17a-3 would be set forth in the second sentence of paragraph (a)(11) of Rule 17a-3, as proposed to be amended, and the text of paragraph (a)(11)(ii) would be deleted from the rule.²²⁵

²²¹ The proposed amendments would replace the phrase “shall mean” with the word “means” in the following paragraphs of Rule 17a-3, as proposed to be amended: (a)(6)(i)(A), (a)(16)(ii)(A), and (a)(16)(ii)(B). See Rule 17a-3, as proposed to be amended.

²²² The Commission proposes the following stylistic and corrective changes to Rule 17a-3, as proposed to be amended: (1) adding to paragraph (a)(1) the phrase “such securities were”; (2) adding to paragraph (a)(4)(vi) the word “and” after the semicolon; (3) replacing the word “of” with the word “or” in paragraph (a)(5), resulting in the phrase “for its account or for the account of its customers or partners”; (4) replacing the phrase “purchase or sale of securities” with the phrase “purchase or sale of a security” in the first sentence of paragraph (a)(6)(i); (5) replacing the word “and” with the word “or” in paragraph (a)(7), resulting in the phrase “A memorandum of each purchase or sale”; (6) replacing the phrase “in respect of” with the phrase “with respect to” in paragraph (a)(9); (7) adding the phrase “, as applicable:” after the word “indicating” in paragraph (a)(9); (8) including the word “and” between the second-to-last and last subparagraphs of paragraph (a)(9) (instead of after every subparagraph); (9) replacing cross-reference in paragraph (a)(12) to “paragraph (h)(4)” with a cross-reference to “paragraph (f)(4)” due to the proposed deletion of two paragraphs; (10) amending paragraph (a)(12)(i)(G) to refer to a “broker or dealer” instead of a “broker-dealer”; and (11) replacing the superfluous “or” with a comma in the phrase “wrongful taking of property or bribery” in paragraph (a)(12)(i)(G).

²²³ See undesignated introductory paragraph of Rule 17a-3, as proposed to be amended.

²²⁴ See paragraph (a)(11) of Rule 17a-3, as proposed to be amended.

²²⁵ Id.

The Commission is proposing to amend the “Provided, however” paragraph in paragraph (a)(12) of Rule 17a-3 that follows paragraph (a)(12)(i)(H) by replacing the list of SROs and exchanges with the term “a self-regulatory organization.”²²⁶ Thus, rather than naming specific SROs, the paragraph would use the generic term “a self-regulatory organization.”

The Commission also is proposing amendments to paragraph (b) of Rule 17a-3. Paragraph (b)(1) is designed to avoid duplication and prevent an introducing broker-dealer from having to make and keep current the same records that would customarily be made by the firm’s clearing broker-dealer. However, the language in paragraph (b)(1) beginning with the phrase “Provided, That” is outdated insofar as it references a capital standard that has been superseded. In revising paragraph (b)(1), the intent of the provision – to avoid the duplicative creation of records related to transactions introduced by one broker or dealer and cleared by a different broker or dealer – remains the same. However, the Commission is proposing to clarify the provision and eliminate the outdated capital standard reference.²²⁷ The Commission also is proposing to delete paragraph (b)(2) as it would be redundant of paragraph (b) of Rule 17a-3, as proposed to be amended.

The Commission is proposing to remove paragraphs (c) and (d) of Rule 17a-3. Paragraph (c) is outdated and references instruments such as U.S. Defense Savings Stamps and U.S. Defense Savings Bonds that are no longer widely circulated and thus a specific carve-out for

²²⁶ See paragraph (a)(12) of Rule 17a-3, as proposed to be amended.

²²⁷ Paragraph (b) of Rule 17a-3, as proposed to be amended, would read as follows: “A broker or dealer registered pursuant to section 15 of the Act, that introduces accounts on a fully-disclosed basis, is not required to make or keep such records of transactions cleared for such broker or dealer as are made and kept by a clearing broker or dealer pursuant to the requirements of § 240.17a-3 and § 240.17a-4. Nothing herein will be deemed to relieve such broker or dealer from the responsibility that such books and records be accurately maintained and preserved as specified in § 240.17a-3 and § 240.17a-4.”

these instruments from the general rule set forth in paragraph (a) of Rule 17a-3 is antiquated.²²⁸ Paragraph (d) provides a de minimis exception from paragraph (a) of Rule 17a-3 for any cash transaction of \$100 or less involving only subscription rights or warrants which by their terms expire within 90 days after the issuance thereof. This exemption was adopted in 1953 to reduce the burden and expense of making accounting entries for these rights transactions. The Commission preliminarily believes that the burden associated with these accounting entries is no longer significant in light of the technological advances in recordkeeping systems since 1953.²²⁹ In addition, the Commission preliminarily believes the removal of this exemption would affect a small number of transactions.

As a consequence of the proposed removal of current paragraphs (c) and (d) from Rule 17a-3, current paragraphs (e), (f), (g), and (h) would be redesignated as paragraphs (c), (d), (e), and (f), respectively.

Current paragraph (e) references Municipal Securities Rulemaking Board ("MSRB") Rule G-8 and states that compliance with such rule will be deemed to be compliance with this section. The proposed amendments would add the phrase "or any successor rule" to the reference to Rule G-8 so that the cross-reference does not become superseded over time.

²²⁸ The Defense Savings Bond initiated by the U.S. Treasury and the U.S. Defense Savings Stamps introduced by the U.S. Postal Service were measures to finance the U.S. effort in World Wars I and II. The bonds matured in 10 years from the date of issuance. The Defense Savings Bonds were replaced by Series E savings bonds, which ceased to be issued as of June 1980. Today, these instruments are not widely held and are valued more as collectibles than for their face value. See information available at www.Treasurydirect.gov.

²²⁹ See Preservation of Records and Reports of Certain Stabilizing Activities, 18 FR 2879 (May 19, 1953) ("It has been pointed out to the Commission that the accounting entries appropriate in the case of the usual securities transaction are unnecessarily burdensome and expensive as to these rights transactions because of the small sums involved and because in many cases there is no continuing relationship between the customer and the firm").

Request for Comment

The Commission generally requests comment on these additional proposed amendments to Rule 17a-3, including comment on whether any of the proposed amendments would result in substantive changes to the requirements applicable to broker-dealers. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Paragraphs (a)(12)(i)(E) through (G) of Rule 17a-3 currently require broker-dealers to retain certain records with regard to certain actions taken against their associated persons when they were associated with a broker-dealer. Should these requirements be expanded to include actions taken when they were associated with other types of entities (e.g., SBSBs, MSBSBs, FCMs, investment advisers)? If so, which entities should be covered? Please explain. Also identify, estimate, and quantify any associated burdens with expanding these requirements to include actions taken when broker-dealers are associated with these other types of entities.
2. Do broker-dealers still rely on the exemptions provided in paragraphs (b)(2), (c), and/or (d) of Rule 17a-3? If so, quantify the extent to which these exemptions are relied on, and the burden associated with the Commission's proposal to eliminate these exemptions. In addition, would any system changes be needed if the exemptions provided in paragraphs (b)(2), (c), and/or (d) of Rule 17a-3 were eliminated? If so, identify, estimate, and quantify the burden(s) associated with such system changes.

3. Record Maintenance and Preservation Requirements

As discussed above, Rule 17a-4 requires a broker-dealer to preserve certain types of records if it makes or receives them. The rule also prescribes the period of time these records and the records required to be made and kept current under Rule 17a-3 must be preserved and the

manner in which they must be preserved. The Commission is proposing amendments to Rule 17a-4 that are designed to account for the security-based swap activities of broker-dealers, including broker-dealer SBSs and broker-dealer MSBSs.²³⁰ The Commission also is proposing additional largely technical amendments to Rule 17a-4. With respect to stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs, the Commission is proposing new Rule 18a-6 – which is modeled on Rule 17a-4, as proposed to be amended – to establish record maintenance and preservation requirements for these types of registrants.

For the reasons discussed above in sections I. and II.A.1. of this release, proposed Rule 18a-6 does not include a parallel requirement for every requirement in Rule 17a-4.²³¹ In addition, for the reasons described in section I. of this release, the recordkeeping requirements in proposed Rule 18a-6 applicable to bank SBSs and bank MSBSs are more limited in scope than the requirements in the rule applicable to stand-alone SBSs and stand-alone MSBSs.

The proposed amendments to Rule 17a-4 and proposed Rule 18a-6 are discussed in more detail below.

a. Amendments to Rule 17a-4 and Proposed Rule 18a-6

Undesignated Introductory Paragraph

Rule 17a-4, as proposed to be amended, would contain an undesignated introductory paragraph explaining that the rule applies to a broker-dealer, including a broker-dealer dually

²³⁰ Broker-Dealer SBSs and broker-dealer MSBSs would be subject to all the record maintenance and preservation requirements applicable to broker-dealers under Rule 17a-4, as proposed to be amended, plus the additional requirements specifically applicable only to SBSs and MSBSs.

²³¹ The Commission is not proposing to include in proposed Rule 18a-6 requirements that would parallel the requirements in paragraphs (b)(11), (g), (h), (k), and (l) of Rule 17a-4. These requirements relate to activities that the Commission preliminarily believes would not be relevant to stand-alone SBSs or stand-alone MSBSs. Other requirements in Rule 17a-4 that would not be included as parallel requirements in proposed Rule 18a-6 are discussed below.

registered with the Commission as an SBSBSP or MSBSP.²³² The note further explains that an SBSBSP or MSBSP that is not dually registered as a broker-dealer (i.e., a stand-alone SBSBSP, stand-alone MSBSP, bank SBSBSP, or bank MSBSP) is subject to the record maintenance and preservation requirements under proposed Rule 18a-6.²³³

Similarly, proposed Rule 18a-6 would contain an undesignated introductory paragraph explaining that the rule applies to an SBSBSP or MSBSP that is not registered as a broker-dealer.²³⁴ The note further explains that a broker-dealer that is dually registered as an SBSBSP or MSBSP is subject to the record maintenance and preservation requirements under Rule 17a-4.²³⁵

Six Year Preservation Requirement for Certain Rule 17a-3 and Rule 18a-5 Records

Paragraph (a) of Rule 17a-4 provides that brokers-dealers subject to Rule 17a-3 must preserve for a period of not less than six years, the first two years in an easily accessible place, certain categories of records required to be made and kept current under Rule 17a-3 (the “six year preservation requirement”).²³⁶ Specifically, the six year preservation requirement applies to records required under the following paragraphs of Rule 17a-3, as proposed to be amended: paragraph (a)(1) (trade blotters); paragraph (a)(2) (general ledgers); paragraph (a)(3) (ledgers of customer and non-customer accounts); paragraph (a)(5) (stock record); paragraph (a)(21) (person who can explain records at each office); paragraph (a)(22) (principal responsible for establishing compliance procedures); and paragraph (d) (security future product records).²³⁷ Consequently, broker-dealer SBSBSPs and broker-dealer MSBSPs would be required to preserve

²³² See undesignated introductory paragraph of Rule 17a-4, as proposed to be amended.

²³³ Id.

²³⁴ See undesignated introductory paragraph of proposed Rule 18a-6.

²³⁵ Id.

²³⁶ See 17 CFR 240.17a-4(a).

²³⁷ Id. As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to paragraph (a) of Rule 17a-4.

for six years the same categories of records as broker-dealers not registered as SBSs or MSBSPs.²³⁸

As discussed above in section II.A.2.a. of this release, paragraphs (a) and (b) of proposed Rule 18a-5 would contain certain recordkeeping requirements that are parallel to existing requirements in Rule 17a-3. Under these parallel requirements, stand-alone SBSs, stand-alone MSBSPs, bank SBSs, and bank MSBSPs would need to make and keep current certain categories of records that broker-dealers must maintain under the six year preservation requirement in Rule 17a-4. Consequently, paragraph (a) of proposed Rule 18a-6 similarly would require that these categories of records must be preserved for a period of not less than six years, the first two years in an easily accessible place.²³⁹ Further, similar to paragraphs (a) and (b) of proposed Rule 18a-5, paragraph (a) of proposed Rule 18a-6 contains one set of six year preservation requirements applicable to stand-alone SBSs and stand-alone MSBSPs and a separate set applicable to bank SBSs and bank MSBSPs.²⁴⁰

In particular, paragraph (a)(1) of proposed Rule 18a-6 would apply to stand-alone SBSs and stand-alone MSBSPs.²⁴¹ These registrants would be required to preserve for at least six years, the first two years in an easily accessible place, the records required to be made and kept current under the following paragraphs of proposed Rule 18a-5: paragraph (a)(1) (trade blotters); paragraph (a)(2) (general ledgers); paragraph (a)(3) (ledgers of customer and non-customer accounts); and paragraph (a)(4) (stock record).²⁴² Paragraph (a)(2) of proposed Rule 18a-6

²³⁸ See paragraph (a) of Rule 17a-4, as proposed to be amended.

²³⁹ See paragraph (a) of proposed Rule 18a-6.

²⁴⁰ Id.

²⁴¹ See paragraph (a)(1) of proposed Rule 18a-6 (providing that it applies to SBSs and MSBSPs subject to paragraph (a) of proposed Rule 18a-5).

²⁴² See paragraph (a)(1) of proposed Rule 18a-6.

would apply to bank SBSBs and bank MSBSBs.²⁴³ These registrants would be required to preserve for at least six years, the first two years in an easily accessible place, the records required under the following paragraphs of proposed Rule 18a-5: paragraph (b)(1) (trade blotters); paragraph (b)(2) (ledgers of security-based swap customers and non-customers); and paragraph (b)(3) (stock record).²⁴⁴

Three Year Preservation Requirement for Certain Rule 17a-3 and Rule 18a-5 Records

Paragraph (b) of Rule 17a-4 provides that broker-dealers subject to Rule 17a-3 must preserve for at least three years, the first two years in an easily accessible place, certain records required to be made and kept current under Rule 17a-3 (the “three year preservation requirement”).²⁴⁵ Specifically, paragraph (b)(1) of Rule 17a-4 imposes the three year preservation requirement on the records required to be made and kept current under the following paragraphs of Rule 17a-3, as proposed to be amended: paragraph (a)(4) (certain ledgers); paragraph (a)(6) (memoranda of brokerage orders); paragraph (a)(7) (memoranda of proprietary orders); paragraph (a)(8) (confirmations); paragraph (a)(9) (accountholder information); paragraph (a)(10) (options positions); paragraph (a)(16) (internal broker-dealer system); paragraph (a)(18) (associated person complaints); paragraph (a)(19) (associated person compensation); paragraph (a)(20) (advertisement and sales literature compliance); and paragraph (e) (records of each broker-dealer office).²⁴⁶

²⁴³ See paragraph (a)(2) of proposed Rule 18a-6 (providing that it applies to SBSBs and MSBSBs subject to paragraph (b) of proposed Rule 18a-5).

²⁴⁴ See paragraph (a)(2) of proposed Rule 18a-6.

²⁴⁵ See 17 CFR 240.17a-4(b).

²⁴⁶ Id. Currently, Rule 17a-4 does not cross-reference paragraph (a)(11) of Rule 17a-3 (trial balances and computation of net capital). See 17 CFR 240.17a-3(a)(11); 17 CFR 240.17a-4. The Commission is proposing to correct this omission by adding a cross reference to paragraph (a)(11) of Rule 17a-3 in paragraph (b)(1) of Rule 17a-4, as proposed to be amended. This would require broker-dealers to preserve these records for three years, the first two year in an easily accessible place. Based on staff experience, the

The Commission is not proposing to amend or change any of the existing cross-references to Rule 17a-3 in paragraph (b)(1) of Rule 17a-4.²⁴⁷ The Commission is, however, proposing to add cross-references to certain new paragraphs that would be added to Rule 17a-3 to address security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs. Specifically, paragraph (b)(1) of Rule 17a-4, as proposed to be amended, would apply the three year preservation requirement to the records required under the following paragraphs of Rule 17a-3, as proposed to be amended: paragraph (a)(24) (liquidity stress test); paragraph (a)(25) (proposed Rule 18a-3 calculations); paragraph (a)(26) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(27) (proposed Rule 18a-4 reserve account computations); paragraph (a)(28) (unverified transactions); paragraph (a)(29) (political contributions); and paragraph (a)(30) (compliance with external business conduct requirements).²⁴⁸

As discussed above in section II.A.2.a. of this release, paragraphs (a) and (b) of proposed Rule 18a-5 would require stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs to make and keep current certain categories of records that broker-dealers are required to make and keep current under Rule 17a-3 and certain categories of records the Commission is proposing broker-dealers be required to make and keep current under amendments to Rule 17a-3. Under these parallel requirements, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would need to make and keep current certain categories of records that currently are subject to the three year preservation requirement in Rule 17a-4 or, with respect to the new categories of records, are proposed to be subject to the three year preservation requirement.

Commission believes that broker-dealers have been preserving these records in a manner consistent with this proposed requirement.

²⁴⁷ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended.

²⁴⁸ Id.

Consequently, paragraph (b) of proposed Rule 18a-6 would similarly require that these categories of records be preserved for a period of not less than three years, the first two years in an easily accessible place.²⁴⁹ Further, similar to paragraph (a) of proposed Rule 18a-6, paragraph (b) would contain two sets of provisions.²⁵⁰

Paragraph (b)(1)(i) of proposed Rule 18a-6 would apply to stand-alone SBSs and stand-alone MSBSPs.²⁵¹ These registrants would be required to preserve for a period of not less than three years, the first two years in an easily accessible place, the records required to be made and kept current under the following paragraphs of proposed Rule 18a-5, as applicable: paragraph (a)(5) (memoranda of proprietary orders); paragraph (a)(6) (confirmations); paragraph (a)(7) (account holder information); paragraph (a)(8) (options positions); paragraph (a)(9) (trial balances and computation of net capital or tangible net worth); paragraph (a)(11) (liquidity stress test); paragraph (a)(12) (proposed Rule 18a-3 calculations); paragraph (a)(13) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(14) (proposed Rule 18a-4 reserve account computations); paragraph (a)(15) (unverified transactions); paragraph (a)(16) (political contributions); and paragraph (a)(17) (compliance with external business conduct requirements).²⁵²

Paragraph (b)(2) of proposed Rule 18a-6 would apply to bank SBSs and bank MSBSPs.²⁵³ These registrants would be required to preserve for a period of not less than three years, the first two years in an easily accessible place, the records required to be made and kept

²⁴⁹ See paragraph (b) of proposed Rule 18a-6.

²⁵⁰ Id.

²⁵¹ See paragraph (b)(1)(i) of proposed Rule 18a-6 (providing that it applies to SBSs and MSBSPs subject to paragraph (a) of proposed Rule 18a-5).

²⁵² See paragraph (b)(1)(i) of proposed Rule 18a-6.

²⁵³ See paragraph (b)(2) of proposed Rule 18a-6 (providing that it applies to SBSs and MSBSPs subject to paragraph (b) of proposed Rule 18a-5).

current under the following paragraphs of proposed Rule 18a-5, as applicable: paragraph (b)(4) (memoranda of brokerage orders); paragraph (b)(5) (memoranda of proprietary orders); paragraph (b)(6) (confirmations); paragraph (b)(7) (accountholder information); paragraph (b)(9) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (b)(10) (proposed Rule 18a-4 reserve account computations); paragraph (b)(11) (unverified transactions); paragraph (b)(12) (political contributions); and paragraph (b)(13) (compliance with external business conduct requirements).²⁵⁴

Three Year Preservation Requirement for Certain Other Records

Paragraph (b) of Rule 17a-4 also provides that a broker-dealer subject to Rule 17a-3 must preserve for a period of not less than three years, the first two years in an easily accessible place, other categories of records if the broker-dealer makes or receives the record.²⁵⁵ These are not categories of records a broker-dealer is required to make and keep current under Rule 17a-3 but rather types of records that a broker-dealer may make or receive in the ordinary course of business.²⁵⁶

As discussed in detail below, the Commission is proposing amendments to these provisions in paragraph (b) of Rule 17a-4 to account for security-based swaps, and is proposing amendments requiring that broker-dealers, including broker-dealer SBSs and broker-dealer MSBSs, preserve certain additional records related to security-based swap activities. Further, the Commission is proposing in paragraph (b) of proposed Rule 18a-6 that stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs be required to preserve similar records.

²⁵⁴ See paragraph (b)(2)(i) of proposed Rule 18a-6.

²⁵⁵ See 17 CFR 240.17a-4(b)(2) through (12).

²⁵⁶ Id.

In addition, paragraphs (b)(3), (b)(4), (b)(5), and (b)(7) of Rule 17a-4 require the preservation of certain types of records if they relate to the broker-dealer's business as such (i.e., as a broker-dealer).²⁵⁷ Security-based swap activities of a broker-dealer that is not registered as an SBSB or MSBSP would be part of the broker-dealer's business as such for the purposes of Rule 17a-4 just like activities relating to other types of securities. In the case of a broker-dealer SBSB or broker-dealer MSBSP, the Commission is proposing to amend paragraph (m) of Rule 17a-4 to make clear that the business as such of a broker-dealer dually registered as an SBSB or MSBSP would include the firm's business as an SBSB or MSBSP.²⁵⁸

The following is a discussion of the proposed amendments to Rule 17a-4 with respect to certain other records that would be subject to the three year preservation requirement and parallel provisions that would be included in proposed Rule 18a-6.

Bank Records. Paragraph (b)(2) of Rule 17a-4 requires broker-dealers to preserve all check books, bank statements, cancelled checks, and cash reconciliations.²⁵⁹ The Commission is not proposing to amend paragraph (b)(2) of Rule 17a-4 to specifically account for security-based swaps. However, the Commission is proposing to include a parallel requirement in paragraph (b)(1) of Rule 18a-6 that would mirror paragraph (b)(2) of Rule 17a-4.²⁶⁰ In particular, paragraph (b)(1)(ii) would require stand-alone SBSBs and stand-alone MSBSPs to preserve these types of bank records.²⁶¹

Bills. Paragraph (b)(3) of Rule 17a-4 requires broker-dealers, which would include broker-dealer SBSBs and broker-dealer MSBSPs, to preserve all bills receivable or payable, paid

²⁵⁷ See 17 CFR 240.17a-4(b)(3) through (5) and (b)(7).

²⁵⁸ See paragraph (m)(5) of Rule 17a-4, as proposed to be amended.

²⁵⁹ See 17 CFR 240.17a-4(b)(2).

²⁶⁰ Compare paragraph (b)(1)(ii) of proposed Rule 18a-6, with 17 CFR 240.17a-4(b)(2).

²⁶¹ See paragraph (b)(1)(ii) of proposed Rule 18a-6.

or unpaid, relating to the business of the member, broker, or dealer.²⁶² The Commission is proposing to include a parallel requirement in paragraph (b)(1) of proposed Rule 18a-6 that would mirror paragraph (b)(3) of Rule 17a-4.²⁶³ In particular, paragraph (b)(1)(iii) of proposed Rule 18a-6 would require stand-alone SBSDs and stand-alone MSBSPs to preserve these types of bills.²⁶⁴

Communications. Paragraph (b)(4) of Rule 17a-4 requires broker-dealers to preserve originals of all communications received and copies of all communications sent (and any approvals thereof) by the broker-dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of an SRO of which the broker-dealer is a member regarding communications with the public.²⁶⁵ The Commission is proposing amendments to paragraph (b)(4) to account for security-based swap activities and to include parallel requirements in paragraphs (b)(1) and (b)(2) of proposed Rule 18a-6 that are modeled on paragraph (b)(4) of Rule 17a-4, as proposed to be amended.²⁶⁶

The proposed amendments to paragraph (b)(4) of Rule 17a-4 also would implement section 15F(g)(1) of the Exchange Act.²⁶⁷ Section 15F(g)(1) provides that each registered SBSD and MSBSP shall maintain daily trading records of the security-based swaps of the registered SBSD and MSBSP and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of

²⁶² See 17 CFR 240.17a-4(b)(3).

²⁶³ Compare paragraph (b)(1)(iii) of proposed Rule 18a-6, with 17 CFR 240.17a-4(b)(3).

²⁶⁴ See paragraph (b)(1)(iii) of proposed Rule 18a-6.

²⁶⁵ See 17 CFR 240.17a-4(b)(4). Paragraph (b)(4) of Rule 17a-4 further provides the term communications as used in the paragraph includes sales scripts. Id.

²⁶⁶ Compare paragraphs (b)(1)(iv) and (b)(2)(ii) of proposed Rule 18a-6, with paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

²⁶⁷ See 15 U.S.C. 78o-10(g)(1).

telephone calls, for such period as may be required by the Commission by rule or regulation.²⁶⁸

The term communications, as used in paragraph (b)(4) of Rule 17a-4, includes all electronic communications (e.g., emails and instant messages).²⁶⁹ Moreover, communications related to daily trading of security-based swaps would be communications relating to the business as such of a broker-dealer, including a broker-dealer SBSBSP and broker-dealer MSBSP. Consequently, the Commission need not amend paragraph (b)(4) of Rule 17a-4 to establish a retention period applicable to broker-dealers, including broker-dealer SBSBSPs and broker-dealer MSBSPs, with respect to electronic mail and instant messages relating to their trading in security-based swaps.

However, the Commission has not previously interpreted the term communications to include telephonic communications. Therefore, to implement section 15F(g)(1) of the Exchange Act, the Commission is proposing to amend the preservation requirement in paragraph (b)(4) of Rule 17a-4 to include “recordings of telephone calls required to be maintained pursuant to section 15F(g)(1) of the Exchange Act.”²⁷⁰ Under this proposed requirement, a broker-dealer SBSBSP or a broker-dealer MSBSP would be required to preserve for three years telephone calls

²⁶⁸

Id.

²⁶⁹

See, e.g., Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Exchange Act Release No. 37182 (May 9, 1996), 61 FR 24644 (May 15, 1996), at n. 32 (“Broker-dealers also are subject to recordkeeping requirements that would be applicable to all electronic communications received and sent by the firm relating to its business”); Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 38245 (Feb. 5, 1997), 62 FR 6469 (Feb. 12, 1997); Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR at 55818, 55825 (“Paragraph (b)(4) of Rule 17a-4 previously required that each broker-dealer keep originals of all communications received and copies of all communications sent by the firm relating to its business as a broker-dealer, including inter-office memoranda and communications. With respect to memoranda, including e-mail messages, the Commission has stated that the content and audience of the message determine whether a copy must be preserved, regardless of whether the message was sent on paper or sent electronically”).

²⁷⁰

See paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

that it chooses to record to the extent the calls are required to be maintained pursuant to section 15F(g)(1) of the Exchange Act.²⁷¹

The Commission is proposing to include parallel communication preservation requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs modeled on paragraph (b)(4) of Rule 17a-4, as proposed to be amended.²⁷² The provision applicable to bank SBSDs and bank MSBSPs would limit the requirement to communications that relate to the business of an SBSD or MSBSP.²⁷³

Trial balances. Paragraph (b)(5) of Rule 17a-4 requires broker-dealers, which would include broker-dealer SBSDs and broker-dealer MSBSPs, to preserve all trial balances, computations of aggregate indebtedness and net capital (and working papers in connection therewith), financial statements, branch office reconciliations, and internal audit working papers, relating to the firm's business as a broker-dealer.²⁷⁴ The Commission is proposing to include a parallel requirement in paragraph (b)(1) of proposed Rule 18a-6 applicable to stand-alone SBSDs and stand-alone MSBSPs that is modeled on paragraph (b)(5) of Rule 17a-4.²⁷⁵ In particular, paragraph (b)(1)(v) of proposed Rule 18a-6 would require stand-alone SBSDs and stand-alone MSBSPs to preserve similar types of records.²⁷⁶ In contrast to paragraph (b)(5) of Rule 17a-4, the provision would not refer to computations of "aggregate indebtedness" because this type of computation would not be part of the capital rule for stand-alone SBSDs or stand-alone

²⁷¹ See 15 U.S.C. 78o-10(g)(1).

²⁷² Compare paragraphs (b)(1)(iv) and (b)(2)(ii) of proposed Rule 18a-6, with paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

²⁷³ See paragraph (b)(2)(ii) of proposed Rule 18a-6.

²⁷⁴ See 17 CFR 240.17a-4(b)(5). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to paragraph (b)(5) of proposed Rule 18a-6.

²⁷⁵ Compare paragraph (b)(1)(v) of proposed Rule 18a-6, with 17 CFR 240.17a-4(b)(5).

²⁷⁶ See paragraph (b)(1)(v) of proposed Rule 18a-6.

MSBSPs.²⁷⁷ Further, to account for the proposed capital standard for stand-alone MSBSPs, the paragraph would refer to tangible net worth.²⁷⁸

Account Documents. Paragraph (b)(6) of Rule 17a-4 requires broker-dealers, which would include broker-dealer SBSDs and broker-dealer MSBSPs, to preserve all guarantees of accounts and all powers of attorney and other evidence of the granting of any discretionary authority given in respect of any account, and copies of resolutions empowering an agent to act on behalf of a corporation.²⁷⁹ The Commission is proposing to include parallel requirements in paragraphs (b)(1) and (b)(2) of proposed Rule 18a-6 modeled on paragraph (b)(6) of Rule 17a-4.²⁸⁰ In particular, paragraphs (b)(1)(vi) and (b)(2)(iii) of proposed Rule 18a-6 would require stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, respectively, to preserve similar types of records, but only with respect to security-based swap accounts.²⁸¹ For example, under the proposal, bank SBSDs and bank MSBSPs would not be required to maintain these records with respect to accounts involving exclusively banking related services.

Written Agreements. Paragraph (b)(7) of Rule 17a-4 requires a broker-dealer to preserve all written agreements (or copies thereof) entered into by such broker-dealer relating to its business as such, including agreements with respect to any account.²⁸² The Commission is proposing amendments to paragraph (b)(7) of Rule 17a-4 to account for security-based swaps

²⁷⁷ See paragraph (b)(1)(v) of proposed Rule 18a-6. See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70217–70256.

²⁷⁸ See paragraph (b)(1)(v) of proposed Rule 18a-6. See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70256–70257 (proposing a tangible net worth capital standard for nonbank MSBSPs). A broker-dealer MSBSP would be subject to the net capital requirements in Rule 15c3-1.

²⁷⁹ See 17 CFR 240.17a-4(b)(6).

²⁸⁰ Compare paragraphs (b)(1)(vi) and (b)(2)(iii) of proposed Rule 18a-6, with 17 CFR 240.17a-4(b)(6).

²⁸¹ See paragraphs (b)(1)(vi) and (b)(2)(iii) of proposed Rule 18a-6.

²⁸² See 17 CFR 240.17a-4(b)(7).

and to include parallel requirements in paragraphs (b)(1) and (b)(2) of proposed Rule 18a-6 modeled on paragraph (b)(7) of Rule 17a-4, as proposed to be amended.²⁸³ The amendments to paragraph (b)(7) of Rule 17a-4 would establish a preservation requirement that written agreements with respect to a security-based swap customer or non-customer, including governing documents or any document establishing the terms and conditions of such person's securities-based swaps, must be maintained with such person's account records.²⁸⁴ This provision is designed to facilitate the examination of the broker-dealer by requiring it to maintain these records together.

The parallel requirements in proposed Rule 18a-6 would require stand-alone SBSBs, stand-alone MSBSPs, bank SBSBs, and bank MSBSPs to preserve similar types of records and include the same preservation requirement.²⁸⁵ The provision applicable to bank SBSBs and bank MSBSPs would limit the preservation requirement to written agreements relating to the registrant's business as an SBSB or MSBSP.²⁸⁶

Information Supporting Financial Reports. Paragraph (b)(8) of Rule 17a-4 requires a broker-dealer to preserve records containing various types of information that support amounts included in the broker-dealer's FOCUS Report prepared as of the broker-dealer's audit date and amounts in the annual audited financial statements the broker-dealer is required to file under Rule 17a-5 or Rule 17a-12, as applicable.²⁸⁷ The paragraph specifically identifies the types of supporting information that needs to be preserved, including money balances, securities

²⁸³ Compare paragraphs (b)(1)(vii) and (b)(2)(iv) of proposed Rule 18a-6, with paragraph (b)(7) of Rule 17a-4, as proposed to be amended.

²⁸⁴ See paragraph (b)(7) of Rule 17a-4, as proposed to be amended.

²⁸⁵ See paragraphs (b)(1)(vii) and (b)(2)(iv) of proposed Rule 18a-6.

²⁸⁶ See paragraph (b)(2)(iv) of proposed Rule 18a-6.

²⁸⁷ See 17 CFR 240.17a-4(b)(8); 17 CFR 240.17a-5; 17 CFR 240.17a-12. Rule 17a-12 prescribes reporting requirements for OTC derivatives dealers that are similar to the reporting requirements in Rule 17a-5 applicable to broker-dealers. Compare 17 CFR 240.17a-12, with 17 CFR 240.17a-5.

positions, futures positions, commodity positions, and options positions, among other things.²⁸⁸

The Commission is proposing amendments to paragraph (b)(8) of Rule 17a-4 to account for swap and security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, and to include parallel requirements applicable to stand-alone SBSDs and stand-alone MSBSPs in paragraph (b)(1) of proposed Rule 18a-6 modeled on paragraph (b)(8) of Rule 17a-4, as proposed to be amended.²⁸⁹

The amendments to paragraph (b)(8) of Rule 17a-4 would add a reference to proposed Form SBS in the introductory text after references to certain parts of the FOCUS Report.²⁹⁰ Thus, broker-dealer SBSDs and broker-dealer MSBSPs – which would file proposed Form SBS rather than the FOCUS Report – would need to preserve information in support of proposed Form SBS. Further, the amendments to paragraph (b)(8) of Rule 17a-4 would add the phrase “or swaps” after the phrase “commodity contracts” and the phrase “and swap” after the term “commodity” wherever they appear in the paragraph.²⁹¹ This would require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to preserve the same type of supporting information with respect to swap positions as is required with respect to commodity positions.

Paragraph (b)(8)(xiii) of Rule 17a-4 requires broker-dealers to preserve records containing detail relating to information for possession or control requirements under Rule 15c3-3 and reported on a schedule to certain parts of the FOCUS Report.²⁹² As noted above in

²⁸⁸ See 17 CFR 240.17a-4(b)(8)(i) through (xv).

²⁸⁹ Compare paragraph (b)(1)(viii) of proposed Rule 18a-6, with paragraph (b)(8) of Rule 17a-4, as proposed to be amended.

²⁹⁰ See paragraph (b)(8) of Rule 17a-4, as proposed to be amended.

²⁹¹ See paragraphs (b)(8)(v) through (viii) of Rule 17a-4, as proposed to be amended.

²⁹² See 17 CFR 240.17a-4(b)(8)(xiii).

section II.A.2.a. of this release, Rule 15c3-3 requires a carrying broker-dealer to maintain physical possession or control over customers' fully paid and excess margin securities.²⁹³ The Commission has proposed a parallel requirement in proposed Rule 18a-4 that would apply to SBSDs with respect to their security-based swap customers.²⁹⁴ Moreover, as discussed below in section II.B.2.b. of this release, the Commission is proposing that SBSDs report information relating to possession or control requirements in proposed Form SBS. Consequently, the Commission is proposing to amend paragraph (b)(8) of Rule 17a-4 by adding a new paragraph that is modeled on paragraph (b)(8)(xiii) of Rule 17a-4 but that relates to the possession or control requirements in proposed Rule 18a-4 instead of the possession or control requirements in Rule 15c3-3.²⁹⁵ Thus, broker-dealer SBSDs would be required to preserve records that contain detail relating to information for possession or control requirements under Rule 18a-4 and reported on proposed Form-SBS.

Finally, the Commission's proposed capital requirements for nonbank SBSDs would require these registrants to maintain minimum net capital of not less than the greater of a fixed-dollar amount or a ratio amount.²⁹⁶ The ratio amount for a broker-dealer SBSD would be the sum of the current ratio amount prescribed in Rule 15c3-1 and an amount equal to 8% of the

²⁹³ See 17 CFR 240.15c3-3.

²⁹⁴ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70278-70282.

²⁹⁵ Compare paragraph (b)(8)(xiii) of Rule 17a-4, as proposed to be amended, with 17 CFR 240.17a-4(b)(8)(xiii).

²⁹⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70221-70229. The fixed-dollar amount applicable to nonbank SBSDs, other than ANC broker-dealer SBSDs, would be \$20 million. The fixed dollar amount applicable to ANC broker-dealer SBSDs would be \$1 billion. *Id.* In addition, stand-alone ANC SBSDs would be subject to a \$100 million minimum tentative net capital requirement and ANC broker-dealer SBSDs would be subject to a \$5 billion minimum tentative net capital requirement. *Id.*

firm's risk margin amount ("8% margin factor").²⁹⁷ The ratio amount for a stand-alone SBSB would be an amount equal to the 8% margin factor.²⁹⁸ The term risk margin amount would be defined as the sum of: (1) the greater of the total margin required to be delivered by the nonbank SBSB with respect to security-based swap transactions cleared for security-based swap customers at a clearing agency or the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to paragraph (c)(1)(vi) of Rule 18a-1; and (2) the total margin amount calculated by the stand-alone SBSB with respect to non-cleared security-based swaps pursuant to proposed new Rule 18a-3.²⁹⁹ Accordingly, to determine its minimum net capital requirement, a nonbank SBSB would need to calculate the amount equal to the 8% margin factor.³⁰⁰ The Commission is proposing to amend paragraph (b)(8) of Rule 17a-4 by adding a new paragraph that would require a broker-dealer

²⁹⁷ Id. Rule 15c3-1 prescribes two financial ratio requirements. See 17 CFR 240.15c3-1(a)(1). The first financial ratio requirement provides that a broker-dealer must not permit its aggregate indebtedness to all other persons to exceed 1500% of its net capital (*i.e.*, a 15-to-1 aggregate indebtedness to net capital requirement). See 17 CFR 240.15c3-1(a)(1)(i). Stated another way, the broker-dealer must maintain, at a minimum, an amount of net capital equal to 1/15th (or 6.67%) of its aggregate indebtedness. This financial ratio generally is used by smaller broker-dealers that do not hold customer securities and cash and is the default financial ratio requirement that all broker-dealers must apply unless they affirmatively elect to be subject to the second financial ratio requirement by notifying their designated examining authority ("DEA") of the election. See 17 CFR 240.15c3-1(a)(1)(i) and (ii). The second financial ratio requirement provides that a broker-dealer must not permit its net capital to be less than 2% of aggregate debit items (*i.e.*, customer-related obligations to the broker-dealer). See 17 CFR 240.15c3-1(a)(1)(ii). Customer debit items – computed pursuant to Rule 15c3-3 – consist of, among other things, margin loans to customers and securities borrowed by the broker-dealer to effectuate deliveries of securities sold short by customers. See 17 CFR 240.15c3-3; 17 CFR 240.15c3-3a. This ratio generally is used by larger broker-dealers that hold customer securities and funds.

²⁹⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70221–70229. Neither the 15-to-1 aggregate indebtedness to net capital ratio nor the 2% of aggregate debit items ratio would be applicable to stand-alone SBSBs. Id.

²⁹⁹ Id. at 70223.

³⁰⁰ Id. at 70221–70229.

SBSD to preserve records that contain detail relating to the calculation of the risk margin amount.³⁰¹

As indicated above, the Commission is proposing to include a parallel requirement in paragraph (b)(1) of proposed Rule 18a-6, which is modeled on paragraph (b)(8) of Rule 17a-4, as proposed to be amended.³⁰² Thus, stand-alone SBSBs and stand-alone MSBSPs would be

³⁰¹ See paragraph (b)(8)(xvi) of Rule 17a-4, as proposed to be amended.

³⁰² Compare paragraph (b)(1)(viii) of proposed Rule 18a-6, with paragraph (b)(8) of Rule 17a-4, as proposed to be amended. More specifically: (1) paragraph (b)(1)(viii)(A) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(i) of Rule 17a-4, as proposed to be amended, except the former would refer to security-based swap customers rather than customers and not contain a reference to cash accounts; (2) paragraph (b)(1)(viii)(B) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(ii) of Rule 17a-4, as proposed to be amended, except the former would refer to security-based swap non-customers instead of non-customers and to security-based swap accounts instead of securities accounts, and not contain a reference to cash accounts; (3) paragraph (b)(1)(viii)(C) of proposed Rule 18a-6 would mirror paragraph (b)(8)(iii) of Rule 17a-4, as proposed to be amended; (4) paragraph (b)(1)(viii)(D) of proposed Rule 18a-6 would mirror paragraph (b)(8)(v) of Rule 17a-4, as proposed to be amended; (5) paragraph (b)(1)(viii)(E) of proposed Rule 18a-6 would mirror paragraph (b)(8)(vi) of Rule 17a-4, as proposed to be amended; (6) paragraph (b)(1)(viii)(F) of proposed Rule 18a-6 would mirror paragraph (b)(8)(vii) of Rule 17a-4, as proposed to be amended; (7) paragraph (b)(1)(viii)(G) of proposed Rule 18a-6 would mirror paragraph (b)(8)(viii) of Rule 17a-4, as proposed to be amended; (8) paragraph (b)(1)(viii)(H) of proposed Rule 18a-6 would mirror paragraph (b)(8)(ix) of Rule 17a-4, as proposed to be amended; (9) paragraph (b)(1)(viii)(I) of proposed Rule 18a-6 would mirror paragraph (b)(8)(x) of Rule 17a-4, as proposed to be amended; (10) paragraph (b)(1)(viii)(J) of proposed Rule 18a-6 would mirror paragraph (b)(8)(xi) of Rule 17a-4, as proposed to be amended; (11) paragraph (b)(1)(viii)(K) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(xii) of Rule 17a-4, as proposed to be amended, except the former would refer to proposed Rule 18a-1 (the proposed capital rule for stand-alone SBSBs) rather than Rule 15c3-1 (the broker-dealer capital rule); (12) paragraph (b)(1)(viii)(L) of proposed Rule 18a-6 would mirror paragraph (b)(8)(xiv) of Rule 17a-4, as proposed to be amended; (13) paragraph (b)(1)(viii)(M) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(xv) of Rule 17a-4, as proposed to be amended, except the former would refer to proposed Rule 18a-1 and proposed Rule 18a-2 (the proposed tangible net worth rule for nonbank MSBSPs) rather than Rule 15c3-1; (14) paragraph (b)(1)(viii)(N) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(xvi) of Rule 17a-4, as proposed to be amended, except the former would refer to proposed Rule 18a-1 rather than Rule 15c3-1; and (15) paragraph (b)(1)(viii)(O) of proposed Rule 18a-6 would be modeled on paragraph (b)(8)(xvii) of Rule 17a-4, as proposed to be amended, except the former would refer to proposed Rule 18a-7 (the proposed reporting rule for nonbank SBSBs and nonbank MSBSPs) rather than Rule 17a-5 (the broker-dealer reporting rule) and Rule 17a-12 (the OTC derivatives dealer reporting rule). The Commission is not proposing to include in paragraph (b)(1)(viii) of proposed Rule 18a-6 provisions that would be analogous to paragraphs (b)(8)(iv) and (b)(8)(xiii) of Rule 17a-4, as proposed to be amended. Paragraph (b)(8)(iv) relates to a provision in Rule 15c3-1 for which there is not a parallel provision in proposed Rule 18a-1. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70255–70256. Paragraph (b)(8)(xiii) relates to Rule 15c3-3, which does not apply to stand-alone SBSBs or stand-alone MSBSPs. *Id.* at 70274–70288.

required to preserve similar types of records, as applicable, containing information supporting their financial reports.³⁰³

The Commission is proposing a preservation requirement for bank SBSDs that would require these registrants to preserve the same types of records related to Rule 18a-4 that broker-dealer SBSDs would need to preserve under paragraph (b)(8)(xiv) of Rule 17a-4, as proposed to be amended, and that stand-alone SBSDs would be required to preserve under paragraph (b)(1)(viii)(L) of proposed Rule 18a-6.³⁰⁴ Specifically, bank SBSDs would be required to preserve records containing detail relating to information for possession or control requirements under proposed Rule 18a-4 and reported on proposed Form SBS that is in support of amounts included in the report prepared as of the audit date on proposed Form SBS and in annual audited financial statements required by proposed Rule 18a-7.³⁰⁵

Rule 15c3-4 Risk Management Records. OTC derivatives dealers and ANC broker-dealers are required to comply with Rule 15c3-4.³⁰⁶ This rule requires these types of broker-dealers to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with the firm's business activities, including market, credit, leverage, liquidity, legal, and operational risks.³⁰⁷ The rule also requires periodic reviews (which may be performed by internal audit staff) and annual reviews (which must be conducted

³⁰³ See paragraphs (b)(1)(vii) and (b)(2)(iv) of proposed Rule 18a-6.

³⁰⁴ Compare paragraph (b)(2)(v) of proposed Rule 18a-6, with paragraph (b)(8)(xiv) of Rule 17a-4, as proposed to be amended, and paragraph (b)(1)(viii)(L) of proposed Rule 18a-6.

³⁰⁵ See paragraph (b)(2)(v) of proposed Rule 18a-6.

³⁰⁶ See 17 CFR 240.15c3-4. See also OTC Derivatives Dealers, 63 FR 59362; Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities, and Exchange Act Release No. 49830 (June 8, 2004), 69 FR 34428 (June 21, 2004).

³⁰⁷ See 17 CFR 240.15c3-4.

by independent certified public accountants) of the firm's risk management systems.³⁰⁸

Paragraph (b)(10) of Rule 17a-4 requires broker-dealers subject to Rule 15c3-4 (i.e., OTC derivatives dealers and ANC broker-dealers) to preserve the records required to be made under the rule and the results of the periodic reviews required to be conducted under the rule.³⁰⁹ The Commission has proposed that nonbank SBSDs and nonbank MSBSPs be required to comply with Rule 15c3-4.³¹⁰ Consequently, nonbank SBSDs and nonbank MSBSPs should be required to preserve the same types of records relating to Rule 15c3-4 as ANC broker-dealers and OTC derivatives dealers.³¹¹

Paragraph (b)(10) of Rule 17a-4 applies the preservation requirements for records relating to Rule 15c3-4 to broker-dealers, which includes broker-dealer SBSDs and broker-dealer MSBSPs.³¹² The Commission is proposing to include a parallel requirement in paragraph (b)(1) of proposed Rule 18a-6 applicable to stand-alone SBSDs and stand-alone MSBSPs that would mirror paragraph (b)(10) of Rule 17a-4.³¹³ In particular, paragraph (b)(1)(ix) of proposed Rule 18a-6 would require stand-alone SBSDs and stand-alone MSBSPs to preserve the records required to be made under Rule 15c3-4 and the results of the periodic reviews required to be conducted under the rule.³¹⁴ The Commission did not propose that bank SBSDs and bank

³⁰⁸ See 17 CFR 240.15c3-4(c)(3). The annual review must be conducted in accordance with procedures agreed to by the firm and the independent public accountant conducting the review.

³⁰⁹ See 17 CFR 240.17a-4(b)(10).

³¹⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70250-70251.

³¹¹ See paragraph (b)(1)(ix) of proposed Rule 18a-6.

³¹² See 17 CFR 240.17a-4(b)(10).

³¹³ Compare 17 CFR 240.17a-4(b)(10), with paragraph (b)(1)(ix) of proposed Rule 18a-6.

³¹⁴ See paragraph (b)(1)(ix) of proposed Rule 18a-6.

MSBSPs comply with Rule 15c3-4.³¹⁵ Consequently, the Commission is not proposing a parallel record preservation requirement for these registrants.

Credit Risk Determinations. Under Appendix E to Rule 15c3-1, ANC broker-dealers are permitted to add back to net worth uncollateralized receivables from counterparties arising from OTC derivatives transactions when computing net capital.³¹⁶ Instead of the 100% deduction that applies to most unsecured receivables under Rule 15c3-1, ANC broker-dealers are permitted to take a credit risk charge based on the uncollateralized credit exposure to the counterparty.³¹⁷ In most cases, the credit risk charge is significantly less than a 100% deduction, since it is a percentage of the amount of the receivable that otherwise would be deducted in full. The Commission has proposed that this treatment be narrowed under proposed amendments to the capital requirements for ANC broker-dealers so that it would apply only to uncollateralized receivables from commercial end users arising from security-based swaps (*i.e.*, uncollateralized receivables from other types of counterparties would be subject to the 100% deduction from net worth).³¹⁸ In addition, the proposed capital requirements for nonbank SBSDs permitted to use internal models to calculate market and credit risk charges when computing net capital (*i.e.*, ANC broker-dealer SBSDs and stand-alone ANC SBSDs) similarly would allow these registrants to take credit risk charges with respect to uncollateralized receivables but only from commercial end users arising from security-based swaps.³¹⁹

³¹⁵ See 15 U.S.C. 78o-10(d)(2)(A) (providing that the Commission may not prescribe rules imposing prudential requirements on SBSDs and MSBSPs for which there is a prudential regulator).

³¹⁶ See 17 CFR 240.15c3-1e(c). OTC derivatives dealers are permitted to treat such uncollateralized receivables in a similar manner. See 17 CFR 240.15c3-1f.

³¹⁷ See 17 CFR 240.15c3-1(a)(7); 17 CFR 240.15c3-1e(c).

³¹⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70240-70245.

³¹⁹ See *id.*

The method for computing the credit risk charge is set forth in Appendix E of Rule 15c3-1.³²⁰ Among other things, the amount of the credit risk charge is based on the creditworthiness of the counterparty.³²¹ Paragraphs (c)(4)(vi)(D) and (E) of Appendix E of Rule 15c3-1 require ANC broker-dealers to make and keep current records relating to the bases of their internal credit assessments of counterparties for purposes of the credit risk charge.³²² The Commission has proposed a parallel requirement for stand-alone ANC SBSDs.³²³ Paragraph (b)(12) of Rule 17a-4 requires ANC broker-dealers – and would require ANC broker-dealer SBSDs – to preserve the records required under paragraphs (c)(4)(vi)(D) and (E) of Appendix E of Rule 15c3-1 in accordance with Rule 17a-4.³²⁴ The Commission is proposing to include a parallel requirement in paragraph (b)(1) of proposed Rule 18a-6 applicable to stand-alone ANC SBSDs that is modeled on paragraph (b)(12) of Rule 17a-4.³²⁵ Consequently, stand-alone ANC SBSDs would be required to preserve the same types of records required to be made under proposed Rule 18a-1.

³²⁰ See 17 CFR 240.15c3-1e(c).

³²¹ See *id.* Consistent with section 939A of the Dodd-Frank Act, the Commission recently adopted amendments eliminating the use of credit ratings of nationally recognized statistical rating organizations for the purposes of determining the credit risk charges under Appendix E. See Pub. L. 111-203, 939A; Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934, Exchange Act Release No. 71194 (Dec. 27, 2013), 79 FR 1522 (Jan. 8, 2014). Consequently, an ANC broker-dealer must use internal credit assessments to determine the credit risk charges (as would an ANC broker-dealer SBSD). See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70240-70245 (proposing that stand-alone ANC SBSDs must use internal credit assessments for purposes of determining credit risk charges).

³²² See 17 CFR 240.15c3-1e(c)(4)(vi)(D) and (E).

³²³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70340 (setting forth the text of paragraphs (e)(2)(iv)(F)(1) and (2) of proposed Rule 18a-1).

³²⁴ See 17 CFR 240.17a-4(b)(12).

³²⁵ See paragraph (b)(1)(x) of proposed Rule 18a-6.

Regulation SBSR. Section 13A(a)(1) of the Exchange Act provides that all security-based swaps that are not accepted for clearing shall be subject to regulatory reporting.³²⁶ Section 13(m)(1)(G) of the Exchange Act³²⁷ provides that each security-based swap (whether cleared or uncleared) shall be reported to a registered swap data repository, and section 13(m)(1)(C) of the Exchange Act³²⁸ generally provides that transaction, volume, and pricing data of all security-based swaps shall be publicly disseminated in real time, except in the case of block trades.³²⁹ On November 19, 2010, the Commission proposed Regulation SBSR to implement these requirements.³³⁰ On May 1, 2013, the Commission re-proposed Regulation SBSR as part of its release on cross-border security-based swap activities.³³¹

Re-proposed Regulation SBSR would assign to one side of a security-based swap transaction the duty to report the transaction to a registered swap data repository.³³² Although any type of counterparty could in theory become a reporting side, re-proposed Regulation SBSR includes a reporting hierarchy that would assign the duty primarily to SBSDs and MSBSPs. In addition, re-proposed Regulation SBSR would require SBSDs and MSBSPs to establish,

³²⁶ See 15 U.S.C. 78m-1(a)(1).

³²⁷ See 15 U.S.C. 78m(m)(1)(G).

³²⁸ See 15 U.S.C. 78m(m)(1)(C).

³²⁹ Section 13(m)(1)(E) of the Exchange Act provides, among other things, that, with respect to cleared security-based swaps, the rule promulgated by the Commission related to public dissemination shall contain provisions that specify the criteria for determining what constitutes a large notional security-based swap transaction (block trade) for particular markets and contracts and specify the appropriate time delay for reporting large notional security-based swap transactions (block trades) to the public. 15 U.S.C. 78m(m)(1)(E).

³³⁰ See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 FR 75208.

³³¹ See Cross-Border Security-Based Swap Activities, Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 FR 30968.

³³² See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 FR 75208.

maintain, and enforce written policies and procedures that are reasonably designed to ensure that such entities comply with any security-based swap transaction reporting obligations.³³³

The Commission is proposing to amend paragraph (b) of Rule 17a-4 to add a requirement that broker-dealers, including broker-dealer SBSBs and broker-dealer MSBSBs, preserve the information they are required to submit to a registered swap data repository under Regulation SBSR.³³⁴ In addition, the Commission is proposing to include parallel requirements in paragraphs (b)(1) and (b)(2) of proposed Rule 18a-6.³³⁵ Consequently, stand-alone SBSBs, stand-alone MSBSBs, bank SBSBs, and bank MSBSBs would be required to preserve the same types of records.³³⁶

Records Relating to Business Conduct Standards. As discussed above in section II.A.2.a. of this release, the Commission has proposed Rules 15Fh-1 through 15Fh-6 and Rule 15Fk-1.³³⁷ These rules, among other things, would require SBSBs and MSBSBs to make certain disclosures, provide certain notices, and make other records.³³⁸ The Commission is proposing to amend paragraph (b) of Rule 17a-4 to add a requirement that broker-dealer SBSBs and broker-dealer MSBSBs preserve copies of documents, communications, and notices related to business conduct standards as required under Rules 15Fh-1 through 15Fh-6 and Rule 15Fk-1.³³⁹ In addition, the Commission is proposing to include parallel requirements in paragraphs (b)(1) and (b)(2) of

³³³ See id.

³³⁴ See paragraph (b)(14) of Rule 17a-4, as proposed to be amended.

³³⁵ Compare paragraph (b)(14) of Rule 17a-4, as proposed to be amended, with paragraphs (b)(1)(xi) and (b)(2)(vi) of proposed Rule 18a-6.

³³⁶ See paragraphs (b)(1)(xi) and (b)(2)(vi) of proposed Rule 18a-6.

³³⁷ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR 42396.

³³⁸ See id.

³³⁹ See paragraph (b)(15) of Rule 17a-4, as proposed to be amended.

proposed Rule 18a-6.³⁴⁰ Consequently, stand-alone SBSs, stand-alone MSBSPs, bank SBSs, and bank MSBSPs would be required to preserve the same types of records.³⁴¹

Section 15F(h)(4)(C) of the Exchange Act imposes duties on SBSs that act as advisors to special entities.³⁴² Proposed Rule 15Fh-2(a) would provide an exclusion to the definition of acting as an advisor to a special entity.³⁴³ To fall within the exclusion, the SBS would be required to obtain a written representation from the special entity that it will not rely on recommendations provided by the SBS, and that the special entity will rely on advice from a qualified independent representative (as defined in proposed Rule 15F-5(a)).³⁴⁴ The SBS also would be required to have a reasonable basis to believe that the special entity is advised by a qualified independent representative (as defined in proposed Rule 15F-5(a)), and the SBS would be required to disclose to the special entity that it is not undertaking to act in the best interest of the special entity as otherwise required by section 15F(h)(4) of the Exchange Act.³⁴⁵

If an SBS is acting as an advisor to a special entity, section 15F(h)(4)(C) and proposed Rule 15Fh-4(b) would require the SBS to make reasonable efforts to obtain such information as it considers necessary to make a reasonable determination that a security-based swap or trading strategy involving a security-based swap is in the best interests of the special entity.³⁴⁶ The information that would be required to be collected to make this determination includes, but is not

³⁴⁰ Compare paragraph (b)(15) of Rule 17a-4, as proposed to be amended, with paragraphs (b)(1)(xii) and (b)(2)(vii) of proposed Rule 18a-6.

³⁴¹ See paragraphs (b)(1)(xii) and (b)(2)(vii) of proposed Rule 18a-6.

³⁴² See 15 U.S.C. 78o-10(h)(4)(C).

³⁴³ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42424.

³⁴⁴ See *id.*

³⁴⁵ See *id.*

³⁴⁶ See 15 U.S.C. 78o-10(h)(4)(C); Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42423-42424.

limited to: the authority of the special entity to enter into the transaction; the financial status and future funding needs of the special entity; the tax status of the special entity; the investment or financing objectives of the special entity; the experience of the special entity with respect to security-based swap transactions generally and of the type and complexity being recommended; whether the special entity has the financial capability to withstand changes in market conditions during the term of the security-based swap; and other relevant information.³⁴⁷

Section 15F(h)(5)(A) and proposed Rule 15Fh-5 would require an SBSD or MSBSP that is acting as a counterparty to a special entity to have a reasonable basis to believe that the special entity has an independent representative that is independent of the SBSD or MSBSP and that meets certain specified qualifications, including that the independent representative:

- has sufficient knowledge to evaluate the transaction and related risks;
- is not subject to a statutory disqualification;
- undertakes a duty to act in the best interests of the special entity;
- makes appropriate and timely disclosures to the special entity of material information concerning the security-based swap;
- will provide written representations to the special entity regarding fair pricing and appropriateness of the security-based swap;
- in the case of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), is a fiduciary as defined in section 3(21) of ERISA; and
- in the case of a State, State agency, city, county, municipality, other political subdivision of a State, or governmental plan, is subject to restrictions on certain political contributions.³⁴⁸

The Commission is proposing to amend paragraph (b) of Rule 17a-4 to add a requirement that broker-dealer SBSDs and broker-dealer MSBSPs preserve records relating to the

³⁴⁷ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42423-42424.

³⁴⁸ See id. at 42428, n. 224.

determinations made pursuant to section 15F(h)(4)(C) and section 15F(h)(5)(A) of the Exchange Act.³⁴⁹ In addition, the Commission is proposing to include parallel requirements in paragraphs (b)(1) and (b)(2) of proposed Rule 18a-6.³⁵⁰ Consequently, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be required to preserve the same types of records.³⁵¹

Corporate Documents

Paragraph (d) of Rule 17a-4 requires broker-dealers to preserve during the life of the enterprise corporate documents such as articles of incorporation, minute books, and stock certificate books.³⁵² It also requires broker-dealers to preserve during the life of the enterprise registration and licensing information such as all Forms BD, Forms BDW, and licenses or other documentation showing registration with a securities regulatory authority.³⁵³ The Commission is proposing to amend paragraph (d) of Rule 17a-4 to add references to proposed Form SBSE-BD and proposed Form SBSE-W.³⁵⁴ Forms SBSE and SBSE-W are the registration and withdrawal of registration forms, respectively, the Commission has proposed for broker-dealer SBSDs and broker-dealer MSBSPs.³⁵⁵

The Commission is proposing to include a parallel requirement in paragraph (c) of proposed Rule 18a-6 that is modeled on paragraph (d) of Rule 17a-4, as proposed to be

³⁴⁹ See paragraph (b)(16) of Rule 17a-4, as proposed to be amended.

³⁵⁰ Compare paragraph (b)(16) of Rule 17a-4, as proposed to be amended, with paragraphs (b)(1)(xiii) and (b)(2)(viii) of proposed Rule 18a-6.

³⁵¹ See paragraphs (b)(1)(xiii) and (b)(2)(viii) of proposed Rule 18a-6.

³⁵² See 17 CFR 240.17a-4(d).

³⁵³ See *id.*

³⁵⁴ See paragraph (d) of Rule 17a-4, as proposed to be amended.

³⁵⁵ See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784 (Oct. 24, 2011).

amended.³⁵⁶ This would require stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs to preserve the same types of records during the life of the enterprise.³⁵⁷

Paragraph (c) of proposed Rule 18a-6 would reference proposed Form SBSE and proposed Form SBSE-A rather than proposed Form SBSE-BD because these are the registration forms that the Commission has proposed for SBSs and MSBSs that are not dually registered as broker-dealers.³⁵⁸

Associated Persons

As discussed above in section II.A.2.a. of this release, paragraph (a)(12) of Rule 17a-3 requires broker-dealers, which would include broker-dealer SBSs and broker-dealer MSBSs, to make and keep current records of information about associated persons of the broker-dealer.³⁵⁹

The Commission is proposing to include parallel requirements in Rule 18a-5 to require stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs to make and keep current the same types of records.³⁶⁰ Paragraph (e)(1) of Rule 17a-4 requires broker-dealers to maintain and preserve these records in an easily accessible place until at least three years after the associated person's employment and any other connection with the broker-dealer has terminated.³⁶¹ The Commission is proposing to include a parallel record maintenance and preservation requirement in proposed Rule 18a-6 that would apply to the associated person

³⁵⁶ Compare paragraph (d) of Rule 17a-4, as proposed to be amended, with paragraph (c) of proposed Rule 18a-6.

³⁵⁷ See paragraph (c) of proposed Rule 18a-6.

³⁵⁸ See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65802-65807.

³⁵⁹ See 17 CFR 240.17a-3(a)(12). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to this paragraph.

³⁶⁰ See paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

³⁶¹ See 17 CFR 240.17a-4(e)(1).

records that stand-alone SBSBs, stand-alone MSBs, bank SBSBs, and bank MSBs would be required to make and keep current.³⁶²

Regulatory Authority Reports

Paragraph (e)(6) of Rule 17a-4 requires broker-dealers, which would include broker-dealer SBSBs and broker-dealer MSBs, to maintain and preserve in an easily accessible place each report that a securities regulatory authority has requested or required the firm to make and furnish to it pursuant to an order of settlement, and each regulatory exam report until three years after the date of the report.³⁶³ The Commission is proposing to include parallel record maintenance and preservation requirements in proposed Rule 18a-6.³⁶⁴ Specifically, paragraph (d)(2)(i) of proposed Rule 18a-6 would require stand-alone SBSBs and stand-alone MSBs to maintain and preserve in an easily accessible place each report which a regulatory authority has requested or required the firm to make and furnish to it pursuant to an order or settlement, and each regulatory authority examination report until three years after the date of the report.³⁶⁵ Paragraph (d)(2)(ii) of proposed Rule 18a-6 would require bank SBSBs and bank MSBs to

³⁶² Compare 17 CFR 240.17a-4(e)(1), with paragraph (d)(1) of proposed Rule 18a-6. Paragraph (h)(2) of proposed Rule 18a-6 would define the term associated person to have the same meaning as that term is defined in paragraph (c) of proposed Rule 18a-5.

³⁶³ See 17 CFR 240.17a-4(e)(6). Paragraph (m)(3) of Rule 17a-4 defines the term security regulatory authority to have the meaning set forth in paragraph (h)(3) of Rule 17a-3. See 17 CFR 240.17a-4(m)(3). Paragraph (h)(3) of Rule 17a-3 defines the term securities regulatory authority to mean the Commission, any self-regulatory organization, or any securities commission (or any agency or office performing like functions) of the States. See 17 CFR 240.17a-3(h)(3). The Commission is proposing to amend this definition to include the CFTC and a prudential regulator to the extent the prudential regulator oversees security-based swap activities. See paragraph (f)(3) of Rule 17a-3, as proposed to be amended. Paragraph (h)(1) of proposed Rule 18a-6 would define the term securities regulatory authority in the same way as that term would be defined in paragraph (f)(3) of Rule 17a-3, as proposed to be amended. Compare paragraph (f)(3) of Rule 17a-3, as proposed to be amended, with paragraph (h)(1) of proposed Rule 18a-6. As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to paragraph (h)(3) of Rule 17a-3.

³⁶⁴ Compare 17 CFR 240.17a-4(e)(6), with paragraphs (d)(2)(i) and (ii) of proposed Rule 18a-6.

³⁶⁵ See paragraph (d)(2)(i) of proposed Rule 18a-6.

maintain and preserve the same types of records for the same period of time, but only if the records relate to security-based swap activities.³⁶⁶

Compliance, Supervisory, and Procedures Manuals

Paragraph (e)(7) of Rule 17a-4 requires broker-dealers, which would include broker-dealer SBSs and broker-dealer MSBSs, to maintain and preserve in an easily accessible place each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the broker-dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the broker-dealer until three years after the termination of the use of the manual.³⁶⁷ The Commission is proposing to include parallel record maintenance and preservation requirements in proposed Rule 18a-6.³⁶⁸ Specifically, paragraph (d)(3)(i) of proposed Rule 18a-6 would require stand-alone SBSs and stand-alone MSBSs to maintain and preserve in an easily accessible place each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the firm with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the firm until three years after the termination of the use of the manual.³⁶⁹ Paragraph (d)(3)(ii) of proposed Rule 18a-6 would require bank SBSs and bank MSBSs to maintain and preserve the same types of compliance,

³⁶⁶ See paragraph (d)(2)(ii) of proposed Rule 18a-6.

³⁶⁷ See 17 CFR 240.17a-4(e)(7). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to this paragraph.

³⁶⁸ Compare 17 CFR 240.17a-4(e)(7), with paragraphs (d)(3)(i) and (ii) of proposed Rule 18a-6.

³⁶⁹ See paragraph (d)(3)(i) of proposed Rule 18a-6.

supervisory, and procedures manuals for the same period of time, but only if the manuals involve compliance with applicable laws and rules relating to security-based swap activities.³⁷⁰

Electronic Storage

Paragraph (f) of Rule 17a-4 provides that the records a broker-dealer, which would include a broker-dealer SBSB or a broker-dealer MSBSP, is required to maintain and preserve under Rule 17a-3 and Rule 17a-4 may be immediately produced or reproduced on micrographic media or by means of electronic storage media.³⁷¹ The rule defines the term micrographic media to mean microfilm or microfiche, or any similar medium.³⁷² The term electronic storage media is defined to mean any digital storage medium or system that meets the requirements set forth in paragraph (f) of Rule 17a-4.³⁷³ Paragraph (f)(2) of Rule 17a-4 prescribes requirements that are specific to the use of electronic storage media and paragraph (f)(3) prescribes requirements that apply to micrographic media and electronic storage media.³⁷⁴ These requirements are designed to ensure ready access to, and the reliability and permanence of, records a broker-dealer maintains and preserves using micrographic or electronic storage media.³⁷⁵ Thus, the requirements, among other things, include safeguards against data erasure, provisions for immediate verification of stored material, and requirements for back-up facilities.³⁷⁶

³⁷⁰ See paragraph (d)(3)(ii) of proposed Rule 18a-6.

³⁷¹ See 17 CFR 240.17a-4(f). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to this paragraph.

³⁷² See 17 CFR 240.17a-4(f)(1)(i).

³⁷³ See 17 CFR 240.17a-4(f)(1)(ii). See also Electronic Storage of Broker-Dealer Records, 68 FR 25281 (Commission interpretation of electronic storage requirements in paragraph (f) of Rule 17a-4).

³⁷⁴ See 17 CFR 240.17a-4(f)(2) and (3).

³⁷⁵ See Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, 62 FR 6469-6470.

³⁷⁶ See id.

The Commission is proposing to include a parallel record maintenance and preservation requirement in proposed Rule 18a-6, but only with respect to electronic storage media.³⁷⁷ The Commission preliminarily believes that SBSBs and MSBSBs that are not dually registered as broker-dealers would not use micrographic media to maintain and preserve records because electronic storage media is more technologically advanced and offers greater flexibility in managing records.³⁷⁸ However, the Commission is seeking comment below on whether proposed Rule 18a-6 should permit micrographic media as an option.

Paragraph (e) of proposed Rule 18a-6 would permit stand-alone SBSBs, stand-alone MSBSBs, bank SBSBs, and bank MSBSBs to use electronic storage media to maintain and preserve the records required to be maintained and preserved under the rule.³⁷⁹ The paragraph would prescribe requirements for using electronic storage media that parallel the requirements in paragraph (f) of Rule 17a-4, which, as discussed above, are designed to ensure ready access to, and the reliability and permanence of, the records.³⁸⁰

Prompt Production of Records

Rule 17a-4 contains provisions designed to ensure that the records a broker-dealer, including a broker-dealer SBSB or broker-dealer MSBSB, is required to maintain and preserve under the rule will be promptly produced to the Commission and other security-regulators. In this regard, paragraph (i) of Rule 17a-4 contains provisions that apply when a broker-dealer uses a third party to prepare or maintain the records required to be maintained and preserved pursuant

³⁷⁷ Compare 17 CFR 240.17a-4(f), with paragraph (e) of proposed Rule 18a-6.

³⁷⁸ The Commission preliminarily believes that most broker-dealers use electronic storage media rather than micrographic media for the same reasons.

³⁷⁹ See paragraph (e) of proposed Rule 18a-6.

³⁸⁰ Compare 17 CFR 240.17a-4(f)(2) and (3), with paragraphs (e)(2) and (3) of proposed Rule 18a-6.

to Rules 17a-3 and 17a-4.³⁸¹ In particular, the paragraph requires the third-party to file with the Commission a written undertaking in a form acceptable to the Commission, signed by a duly authorized person, to the effect that such records are the property of the broker-dealer and will be surrendered promptly on request of the broker-dealer and including the following representation:

With respect to any books and records maintained or preserved on behalf of [broker-dealer], the undersigned hereby undertakes to permit examination of such books and records at any time or from time to time during business hours by representatives or designees of the Securities and Exchange Commission, and to promptly furnish to said Commission or its designee true, correct, complete and current hard copy of any or all or any part of such books and records.³⁸²

The Commission is proposing to include a parallel requirement in proposed Rule 18a-6 that would apply when a stand-alone SBSD, stand-alone MSBSP, bank SBSD, or bank MSBSP uses a third party to prepare or maintain records required pursuant to Rules 18a-5 and 18a-6.³⁸³ Consequently, the third party would be required to file with the Commission an undertaking in which it agrees, among other things, to furnish to the Commission or its designee true, correct, complete, and current hard copy of any or all or any part of such books and records.³⁸⁴

Paragraph (j) of Rule 17a-4 requires a broker-dealer, which would include a broker-dealer SBSD or broker-dealer MSBSP, to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the broker-dealer that are required to be preserved under Rule 17a-4, or any other records of the broker-dealer subject to examination under section 17(b) of the Exchange Act that are requested by the representative

³⁸¹ See 17 CFR 240.17a-4(i). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to this paragraph.

³⁸² Id.

³⁸³ Compare 17 CFR 240.17a-4(i), with paragraph (f) of proposed Rule 18a-6.

³⁸⁴ See paragraph (f) of proposed Rule 18a-6.

of the Commission.³⁸⁵ The Commission is proposing to include a parallel requirement in proposed Rule 18a-6.³⁸⁶ Specifically, paragraph (g) of proposed Rule 18a-6 would require SBSDs and MSBSPs to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the SBSD or MSBSP that are required to be to be preserved under the rule, or any other records of the SBSD or MSBSP subject to examination or required to be made or maintained pursuant to section 15F of the Exchange Act, which are requested by a representative of the Commission.³⁸⁷

Request for Comment

The Commission generally requests comment on the proposals to require broker-dealers, SBSDs, and MSBSPs to maintain and preserve certain records. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the Commission's proposals regarding the records SBSDs and MSBSPs must maintain and preserve under Rule 17a-4, as proposed to be amended, and proposed Rule

³⁸⁵ See 17 CFR 240.17a-4(j). Section 17(b) of the Exchange Act provides, among other things, that all records of a broker-dealer are subject at any time, or from time to time, to such reasonable, periodic, special, or other examinations by representatives of the Commission and the appropriate regulatory agency of the broker-dealer as the Commission or the appropriate regulatory agency deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78q(b). As discussed below in section II.A.3.b. of this release, the Commission is proposing technical amendments to this paragraph.

³⁸⁶ Compare 17 CFR 240.17a-4(j), with paragraph (g) of proposed Rule 18a-6. Section 15F(f)(1)(C) of the Exchange Act provides that SBSDs and MSBSPs shall keep books and records described in sections 15F(f)(1)(B)(i) and (ii) open to inspection and examination by any representative of the Commission. See 15 U.S.C. 78o-10(f)(1)(C). In addition, section 15F(j) of the Exchange Act imposes duties on SBSDs and MSBSPs with respect to monitoring of trading, risk management procedures, disclosing information to the Commission and the prudential regulators, obtaining information, conflicts of interest, and antitrust considerations. See 15 U.S.C. 78o-10(j). With respect to disclosing information, section 15F(j)(3) provides that an SBSD and MSBSP shall disclose to the Commission and to the prudential regulator for the SBSD or MSBSP, as applicable, information concerning: (1) terms and conditions of its security-based swaps; (2) security-based swap trading operations, mechanisms, and practices; (3) financial integrity protections relating to security-based swaps; and (4) other information relevant to its trading in security-based swaps. See 15 U.S.C. 78o-10(j)(3).

³⁸⁷ See paragraph (g) of proposed Rule 18a-6.

18a-6 comprehensive enough to capture all records relating to their activities as SBSBs and MSBSBs, including records that must be made and/or maintained pursuant to provisions in section 15F of the Exchange Act that are not otherwise covered by Rule 17a-4, as proposed to be amended, and proposed Rule 18a-6? Conversely, are these proposals too broad? Explain why or why not. For example, should the Commission establish a catch-all record maintenance and preservation requirement in Rule 17a-4 and proposed Rule 18a-6 that applies to any record relating to the registrant's activities as an SBSB or MSBSB or required to be made and/or maintained pursuant to section 15F of the Exchange Act? Explain why or why not.

2. Are the provisions in Rule 17a-4 that would be included as parallel provisions in proposed Rule 18a-6 applicable to stand-alone SBSBs and stand-alone MSBSBs appropriate for these types of registrants? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them. Are there provisions in Rule 17a-4 that are not being included as parallel provisions in proposed Rule 18a-6 applicable to stand-alone SBSBs and stand-alone MSBSBs that would be appropriate for these types of registrants? If so, explain why.
3. Are the provisions in Rule 17a-4 that would be included as parallel provisions in proposed Rule 18a-6 applicable to bank SBSBs and bank MSBSBs appropriate for these types of registrants? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them. Are there provisions in Rule 17a-4 that are not being included as parallel provisions in proposed Rule 18a-6 applicable to bank SBSBs and bank MSBSBs that would be appropriate for these types of registrants? If so, explain why.

4. Are the recordkeeping provisions that would be added to Rule 17a-4 appropriate for broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs? If not, explain why not. Are there alternative provisions the Commission should consider? If so, describe them.
5. Should proposed Rule 18a-6 include a record storage provision that permits the use of micrographic media? If so, explain why.
6. The Commission proposes to establish a retention period for recordings of telephone calls related to security-based swaps that must be maintained in accordance with section 15F(g) of the Exchange Act. Should the Commission require broker-dealers, SBSDs, and/or MSBSPs to make recordings of telephone calls relating to security-based swaps? Should the Commission require broker-dealers, SBSDs, and/or MSBSPs to retain recordings of telephone calls relating to any topic? Explain why or why not.
7. Should the retention period for recorded telephone calls be different than the proposed three year period? For example, should it be a longer or shorter time frame? If the retention period should be different than three years, explain how long such recordings should be kept and why that different retention period would be more appropriate.
8. Are there recordkeeping requirements currently not included in these proposed rules that should be applied to ANC broker-dealer SBSDs? If so, please describe them.
9. Are there additional requirements that should be included in these proposed rules to promote compliance with the external business conduct standards for SBSDs and MSBSPs? If so, please describe them.

10. Are there additional requirements to promote the disaggregation by the reporting entities of composite security-based swap transactions into segments based on risk as opposed to limiting the data collected to the transaction documents? If so, please describe them.

b. Additional Proposed Amendments to Rule 17a-4

The Commission is proposing several amendments to Rule 17a-4 to eliminate obsolete text, improve readability, and modernize terminology. Reference is made throughout Rule 17a-4 to “members” of a national securities exchange as a distinct class of registrant in addition to brokers-dealers. The Commission is proposing to remove these references to “members” given that the rule applies to brokers-dealers, which would include members of a national securities exchange that are brokers-dealers.³⁸⁸ The Commission is proposing a second global change that would replace the phrase “Every broker and dealer” with “Every broker or dealer”.³⁸⁹

The Commission is proposing a global change that would replace the use of the word “shall” in the rule with the word “must” or “will” where appropriate.³⁹⁰ In paragraph (m) of Rule 17a-4 the Commission would replace the words “shall have” with the word “has”.³⁹¹ The

³⁸⁸ The proposed amendments would delete the word “member” from the title and from the following paragraphs of Rule 17a-4, as proposed to be amended: (a), (b), (b)(3), (b)(4), (b)(5), (b)(7), (c), (d), (e), (e)(1), (e)(6), (e)(7), (e)(8), (f)(2), (f)(3), (i), (j), (k)(1), (k)(2), and (l). See Rule 17a-4, as proposed to be amended.

³⁸⁹ The proposed amendments would replace the phrase “Every broker and dealer” with the phrase “Every broker or dealer” in the following paragraphs of Rule 17a-4, as proposed to be amended: (a), (b), (c), (d), (e), and (j). See Rule 17a-4, as proposed to be amended.

³⁹⁰ The proposed amendments would replace the word “shall” with the word “must” or “will” in the following paragraphs of Rule 17a-4, as proposed to be amended: (a), (b), (b)(11), (c), (d), (e), (e)(8), (f)(2), (f)(3), (g), (i), (j), (k)(1), and (l). See Rule 17a-4, as proposed to be amended.

³⁹¹ The proposed amendments would replace the phrase “shall have” with the word “has” in the following paragraphs of Rule 17a-4, as proposed to be amended: (m)(1), (m)(2), (m)(3), and (m)(4). See Rule 17a-4, as proposed to be amended.

Commission also proposes to make certain stylistic, corrective, and punctuation amendments to improve the readability of Rule 17a-4.³⁹²

Further, as discussed above in section II.A.2.b. of this release, the Commission is proposing to eliminate the requirements in current paragraphs (c) and (d) of Rule 17a-3 and, as a consequence current paragraphs (e), (f), (g), and (h) would be redesignated as paragraphs (c), (d), (e), and (f), respectively. The Commission proposes to amend Rule 17a-4 to make corresponding changes to cross-references to these paragraphs of Rule 17a-3.

Proposed amendments to paragraph (a)(8) would replace the phrase “annual audited financial statements” with the phrase “the annual financial statements” to reflect the broader range of documents required by Rule 17a-5. Due to the insertion of paragraphs (a)(8)(xiv) and (a)(8)(xvi) to Rule 17a-4, as discussed above, the Commission proposes to redesignate paragraphs (a)(8)(xiv) and (a)(8)(xv) as paragraphs (a)(8)(xv) and (a)(8)(xvii), respectively.

Proposed amendments to paragraph (h) would add after the phrase “Rule G-9 of the Municipal Securities Rulemaking Board” the phrase “or any successor rule” to address the possibility of a future change in how the MSRB’s rules are designated.

³⁹²

The Commission proposes the following stylistic and corrective changes to Rule 17a-4, as proposed to be amended: (1) in paragraph (a), replacing the phrases “paragraphs §” and “paragraph §” with the symbols “§§” and “§”, respectively; (2) adding the word “and” between phrase “money balance” and the word “position” in paragraph (b)(8)(i) of Rule 17a-4 for consistency with paragraph (b)(8)(ii) of Rule 17a-4; (3) replacing the phrase “out of the money options” with the phrase “out-of-the-money options” in paragraph (b)(8)(ix) of Rule 17a-4; (4) replacing the phrase “paragraph (a)(12) of § 240.17a-3” with the phrase “§ 240.17a-3(a)(12)” in paragraph (e)(1); (5) replacing the phrase “paragraph (a)(13) of § 240.17a-3” with the phrase “§ 240.17a-3(a)(13)” in paragraph (e)(2); (6) replacing the phrase “paragraph (a)(15) of § 240.17a-3” with the phrase “§ 240.17a-3(a)(15)” in paragraph (e)(3); (7) replacing the phrase “for the life” with the phrase “during the life” in paragraph (e)(3) of Rule 17a-4; (8) replacing the phrase “paragraph (a)(14) of § 240.17a-13” with “§ 240.17a-13(a)(14)” in paragraph (e)(4); (9) replacing the phrase “this paragraph” with the phrase “this section” in paragraph (f); (10) replacing the phrase “each index” with the phrase “the index” in paragraph (f)(3)(iv)(B); (11) replacing the phrase “the self-regulatory organizations” with the phrase “any self-regulatory organization” in paragraph (f)(3)(vi); (12) in paragraph (f)(3)(vii), adding quotation marks around the phrase “the undersigned” to clarify that the phrase is a defined term; (13) replacing the phrase “Rule 17a-4” with the phrase “§ 240.17a-4” in paragraph (f)(3)(vii); and (14) in paragraph (g), replacing the phrase “section 15 of the Securities Exchange Act of 1934 as amended (48 Stat. 895, 49 Stat. 1377; 15 U.S.C. 78o)” with the phrase “section 15 of the Act (15 U.S.C. 78o)”.

Request for Comment

The Commission generally requests comment on these additional proposed amendments to Rule 17a-4, including comment on whether any of the proposed amendments would result in substantive changes to the requirements applicable to broker-dealers.

B. Reporting

1. Introduction

As discussed above, section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.³⁹³ Section 15F(f)(2) provides that the Commission shall adopt rules governing reporting for SBSDs and MSBSPs.³⁹⁴ Further, section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.³⁹⁵ In addition, the Commission has concurrent authority under section 17(a)(1) of the Exchange Act to prescribe reporting requirements for broker-dealers.³⁹⁶

After considering the anticipated business activities of SBSDs and MSBSPs, the Commission is proposing to establish a reporting program for these registrants under sections 15F and 17(a) of the Exchange Act that is modeled on the reporting program for broker-dealers codified in Rule 17a-5.³⁹⁷ Rule 17a-5 – which was recently amended³⁹⁸ – has two main elements: (1) a requirement that broker-dealers file periodic unaudited reports containing

³⁹³ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10.

³⁹⁴ See 15 U.S.C. 78o-10(f)(2).

³⁹⁵ See 15 U.S.C. 78o-10(f)(1)(A).

³⁹⁶ See 15 U.S.C. 78q(a)(1).

³⁹⁷ See 17 CFR 240.17a-5; 17 CFR 249.617.

³⁹⁸ The recent amendments to Rule 17a-5 are discussed below. See Broker-Dealer Reports, Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910 (Aug. 21, 2013). These amendments will not be fully effective until June 1, 2014. This release refers to these amendments as the recently adopted amendments or recently adopted requirements of Rule 17a-5.

information about their financial and operational condition on a FOCUS Report; and (2) a requirement that broker-dealers annually file financial statements and certain reports and a report covering the financial statements and reports prepared by an independent public accountant registered with the Public Company Accounting Oversight Board ("PCAOB") in accordance with PCAOB standards.³⁹⁹

The reporting program established under Rule 17a-5 is designed, among other things, to promote compliance with Rules 15c3-1 and 15c3-3 and to assist the Commission, SROs, and state securities regulators in conducting effective examinations of broker-dealers. As the Commission has stated, the reporting requirements, "together with the Commission's inspection powers, [are] an integral element in the arsenal for protection of customers against the risks involved in leaving securities with their broker-dealer."⁴⁰⁰ The broker-dealer reporting requirements promote transparency of the financial and operational condition of the broker-dealer to the Commission, the firm's DEA, and, in the case of a portion of the annual reports, to the public.⁴⁰¹ In the release adopting Rule 17a-5, the Commission stated its intention to periodically review the reporting requirements "in order to continue modifying and updating the financial and operational reporting systems to keep pace with the changing securities industry."⁴⁰²

Under the proposed reporting program for SBSDs and MSBSPs, broker-dealer SBSDs

³⁹⁹ See id. These requirements are described in more detail below.

⁴⁰⁰ See Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92d Cong., 1st Sess. 6 (1971) at 24.

⁴⁰¹ As discussed below in section II.B.3.a. of this release, paragraph (d) of Rule 17a-5 requires broker-dealers to file certain audited annual reports with the Commission. A portion of these reports is made public.

⁴⁰² See Exchange Act Release No. 11935 (Dec. 17, 1975), 40 FR 59706, 59707 (Dec. 30, 1975).

and broker-dealer MSBSPs – as broker-dealers – would be subject to Rule 17a-5.⁴⁰³ The Commission is proposing amendments to this rule to account for broker-dealers that are dually registered as an SBSD or MSBSP.⁴⁰⁴ Stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be subject to proposed Rule 18a-7, which is modeled on Rule 17a-5, as proposed to be amended. Proposed Rule 18a-7 would not include a parallel requirement for every requirement in Rule 17a-5 because some of the requirements in Rule 17a-5 relate to activities that are not expected or permitted of SBSDs and MSBSPs. Similarly, while all types of SBSDs and MSBSPs would use proposed Form SBS, broker-dealer SBSDs and broker-dealer MSBSPs would be required to provide more information than stand-alone SBSDs and stand-alone MSBSPs.

Further, the reporting requirements in proposed Rule 18a-7 and proposed Form SBS applicable to bank SBSDs and bank MSBSPs are more limited in scope because, as discussed above in section I. of this release, bank SBSDs and bank MSBSPs are subject to reporting requirements applicable to banks. Further, the prudential regulators – rather than the Commission – are responsible for capital, margin, and other prudential requirements applicable to bank SBSDs and bank MSBSPs. For these reasons, the proposed reporting requirements for bank SBSDs and bank MSBSPs generally are designed to be tailored specifically to their activities as an SBSD or an MSBSP (as opposed to their activities as banks). However, as discussed below, the Commission is proposing that bank SBSDs and bank MSBSPs report certain general financial information that banks are required to report pursuant to requirements of

⁴⁰³ Except for the requirement to file one of the parts of the FOCUS Report, broker-dealer SBSDs and broker-dealer MSBSPs would be subject to all the reporting requirements applicable to broker-dealers under Rule 17a-5, as proposed to be amended, plus the additional requirements specifically applicable to an SBSD or MSBSP. As discussed below in section II.B.2. of this release, a broker-dealer SBSD or broker-dealer MSBSP would file proposed Form SBS rather than one of the parts of the FOCUS Report.

⁴⁰⁴ As discussed below in section II.B.3.b. of this release, the Commission also is proposing technical amendments to Rule 17a-5.

the prudential regulators. Bank SBSDs and bank MSBSPs would be able to use the same information reported under the requirements of the prudential regulators to comply with the proposed reporting requirements applicable to bank SBSDs and bank MSBSPs. The objective is to provide the Commission with a means to monitor the financial condition of bank SBSDs and bank MSBSPs without requiring these entities to report information not already reported to their prudential regulators.

2. Periodic Filing of Proposed Form SBS

a. Amendments to Rule 17a-5 and Proposed Rule 18a-7

Undesignated Introductory Paragraph

Rule 17a-5, as proposed to be amended, would contain an undesignated introductory paragraph explaining that the rule applies to a broker-dealer, including a broker-dealer dually registered with the Commission as an SBSD or MSBSP.⁴⁰⁵ The note further explains that an SBSD or MSBSP that is not dually registered as a broker-dealer (*i.e.*, a stand-alone SBSD, stand-alone MSBSP, bank SBSD, or bank MSBSP) is subject to the reporting requirements under proposed Rule 18a-7.⁴⁰⁶ Further, the Commission is proposing to remove paragraph (a)(1) of Rule 17a-5, which provides that paragraph (a) shall apply to every broker-dealer registered pursuant to section 15 of the Exchange Act.⁴⁰⁷ This text would be redundant of the undesignated introductory paragraph of Rule 17a-5, as proposed to be amended.⁴⁰⁸

Similarly, proposed Rule 18a-7 would contain an undesignated introductory paragraph explaining that the rule applies to an SBSD or MSBSP that is not dually registered as a broker-

⁴⁰⁵ See undesignated introductory paragraph of Rule 17a-5, as proposed to be amended.

⁴⁰⁶ See *id.*

⁴⁰⁷ See 17 CFR 240.17a-5(a).

⁴⁰⁸ See undesignated introductory paragraph of Rule 17a-5, as proposed to be amended.

dealer.⁴⁰⁹ The note further explains that a broker-dealer dually registered as an SBSD or MSBSP is subject to the reporting requirements under Rule 17a-5.⁴¹⁰

Requirement to File Proposed Form SBS

Broker-dealers periodically report information about their financial and operational condition on the FOCUS Report Part II, Part IIA, Part IIB, or Part II CSE. Each version of the report is designed for a particular type of broker-dealer and the information to be reported is tailored to the type of broker-dealer. Specifically: (1) the FOCUS Report Part IIA is designed to be used by a broker-dealer that does not hold customer funds or securities;⁴¹¹ (2) the FOCUS Report Part II is designed to be used by a broker-dealer that holds customer funds or securities;⁴¹² (3) the FOCUS Report Part IIB is designed to be used by an OTC derivatives dealer;⁴¹³ and (4) the FOCUS Report Part II CSE is designed to be used by an ANC broker-dealer.⁴¹⁴ The FOCUS Report Part II CSE elicits the most detailed information of the four parts, including the most detail about a firm's derivatives activities.

Paragraph (a) of Rule 17a-5 requires a broker-dealer, other than an OTC derivatives dealer, to file the FOCUS Report Part II or Part IIA.⁴¹⁵ The Commission is proposing to amend

⁴⁰⁹ See undesignated introductory paragraph of proposed Rule 18a-7.

⁴¹⁰ See id.

⁴¹¹ The FOCUS Report Part IIA is available at http://www.sec.gov/about/forms/formx-17a-5_2f.pdf.

⁴¹² The FOCUS Report Part II is available at http://www.sec.gov/about/forms/formx-17a-5_2.pdf.

⁴¹³ The FOCUS Report Part IIB is available at http://www.sec.gov/about/forms/formx-17a-5_2b.pdf.

⁴¹⁴ The FOCUS Report Part II CSE was developed by the New York Stock Exchange, Inc. ("NYSE"). See Exhibit 3 to Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change To Require Members That Use Appendix E To Calculate Net Capital To File Supplemental and Alternative Reports, Exchange Act Release No. 51980 (July 6, 2005), 70 FR 40767 (July 14, 2005). See also Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change to Require Members That Use Appendix E to Calculate Net Capital to File Supplemental and Alternative Reports, Exchange Act Release No. 52269 (Aug. 16, 2005), 70 FR 49349 (Aug. 23, 2005).

⁴¹⁵ See 17 CFR 240.17a-5(a). The requirement that an OTC derivatives dealer file the FOCUS Report Part IIB is set forth in paragraph (a) of Rule 17a-12. See 17 CFR 240.17a-12(a). While an ANC broker-dealer is required under paragraph (a) of Rule 17a-5 to file the FOCUS Report Part IIA, FINRA Rule 4521(b)

this paragraph so that it would require a broker-dealer that is dually registered as an SBSD or MSBSP to file proposed Form SBS rather than the FOCUS Report Part II or Part IIA and to add a parallel requirement in proposed Rule 18a-7 to require stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs to periodically file proposed Form SBS.⁴¹⁶

Currently, paragraph (a)(2) of Rule 17a-5 provides that a broker-dealer must file the FOCUS Report Part II if it clears transactions or carries customer accounts or the FOCUS Report Part IIA if it does not clear transactions or carry customer accounts.⁴¹⁷ The paragraph further provides that these reports must be filed within seventeen business days after the end of the quarter and within seventeen business days after the end of the fiscal year of the broker-dealer if the date of the fiscal year end is not the end of a calendar quarter.⁴¹⁸ Paragraph (a)(3) provides that reports required to be filed with the Commission under paragraph (a) (which includes the reports required under paragraph (a)(2)) shall be considered filed when received at the Commission's principal office in Washington, DC, and the regional office of the Commission for the region in which the broker-dealer has its principal place of business.⁴¹⁹ Paragraph (a)(3)

provides that ANC broker-dealers must file supplemental and alternative reports as may be prescribed by FINRA. Under this rule, FINRA requires ANC broker-dealers to file the FOCUS Report Part II CSE in lieu of the FOCUS Report Part IIA. See also Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change to Require Members That Use Appendix E to Calculate Net Capital to File Supplemental and Alternative Reports, 70 FR 49349 (Commission approval of amendments to NYSE Rule 418 requiring ANC broker-dealers to file Part II CSE).

⁴¹⁶ Compare paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended, with paragraphs (a)(1) and (2) of proposed Rule 18a-7. As a consequence of the proposed removal of paragraph (a)(1) of Rule 17a-5, paragraphs (a)(2)(i), (a)(2)(ii), and (a)(2)(iii) would be redesignated paragraphs (a)(1)(i), (a)(1)(ii), and (a)(1)(iii), respectively. Further, as discussed below, the Commission is proposing to add a new paragraph (a)(1)(iv) to Rule 17a-5. As a consequence of the removal of paragraph (a)(1) and the addition of paragraph (a)(1)(iv), paragraph (a)(2)(iv) would be redesignated paragraph (a)(1)(v). Further, as a consequence of the removal of paragraph (a)(1), paragraphs (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7) of Rule 17a-5 would be redesignated paragraphs (a)(2), (a)(3), (a)(4), (a)(5), and (a)(6), respectively.

⁴¹⁷ See 17 CFR 240.17a-5(a)(2)(ii) and (iii).

⁴¹⁸ See *id.*

⁴¹⁹ See 17 CFR 240.17a-5(a)(3).

further provides that all reports filed pursuant to paragraph (a) shall be deemed to be confidential.⁴²⁰

Notwithstanding these requirements, substantially all broker-dealers file the FOCUS Report directly with their SROs pursuant to plans established by the SROs under paragraph (a)(4) of Rule 17a-5 (rather than filing them directly with the Commission).⁴²¹ Generally, the reporting requirements under the SRO's plans are consistent with, or more rigorous than, the requirements in paragraph (a)(2) of Rule 17a-5 in terms of the part of the FOCUS Report a broker-dealer must file and the frequency of filing.⁴²² Thus, while most broker-dealers do not file the FOCUS Report pursuant to paragraphs (a)(2) and (a)(3) of Rule 17a-5, these provisions establish a baseline for SROs in designing their plans, which must be declared effective by the Commission.

The Commission is proposing to amend paragraph (a)(2) of Rule 17a-5 to account for the fact that some broker-dealers likely will be registered as an SBSD or potentially as an MSBSP

⁴²⁰ See *id.*

⁴²¹ Specifically, paragraph (a)(4) of Rule 17a-5 contains an exception from the requirement to file the FOCUS Report directly with the Commission applicable to brokers-dealers that are members of a national securities exchange or a registered national securities association if the exchange or association maintains records containing the information required by the FOCUS Report and transmits such information to the Commission pursuant to a plan that has been submitted to, and declared effective by, the Commission ("FOCUS filing plan" or "Plan"). See 17 CFR 240.17a-5(a)(4). FINRA and other SROs have had FOCUS filing plans in effect since the 1970s under this exception. See, e.g., Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Association's FOCUS Filing Plan, Exchange Act Release No. 36780, (Jan. 26, 1996), 61 FR 3743 (Feb. 1, 1996).

⁴²² Currently, FINRA's plan (which applies to most broker-dealers) requires monthly filing of the FOCUS Report Part II for members that are subject to the requirements of paragraph (e) of Rule 15c3-3, or that conduct a business in accordance with paragraph (k)(2)(i) of Rule 15c3-3, or that are subject to paragraphs (a)(2)(i) through (iii) of Rule 15c3-1. See 17 CFR 240.15c3-1(a)(2)(i) through (iii); 17 CFR 240.15c3-3(e) and (k)(2)(i). FINRA's plan requires quarterly filing of the FOCUS Report Part IIA for members that conduct a business in accordance with the provisions of paragraph (k)(1)(i) through (iii), (k)(2)(ii), and (k)(3) of Rule 15c3-3 and are not subject to paragraphs (a)(2)(i) through (iii) of Rule 15c3-1, and for members that conduct a business in accordance with paragraphs (a)(6) through (8) of Rule 15c3-1. See 17 CFR 240.15c3-1(a)(2)(i) through (iii) and (a)(6) through (8); 17 CFR 240.15c3-3(k)(1)(i) through (iii), (k)(2)(ii), and (k)(3). These firms generally are non-carrying broker-dealers and firms that do not meet the definition of dealer under Rule 15c3-1. Further, as noted above, ANC broker-dealers file the FOCUS Report Part II CSE pursuant to FINRA Rule 4521(b) rather than the FOCUS Report Part II.

and, therefore, these categories of registrants would be subject to the reporting requirements under Rule 17a-5.⁴²³ The proposed amendments would require broker-dealer SBSDs and broker-dealer MSBSPs to file proposed Form SBS rather than the FOCUS Report Part II or Part IIA. Specifically, the amendments would specify that the requirement to file the FOCUS Report Part II or Part IIA directly with the Commission in paragraph (a) applies only to broker-dealers that are not dually registered as an SBSD or MSBSP.⁴²⁴ In addition, the Commission proposes to add a new paragraph (a)(1)(iv) to Rule 17a-5.⁴²⁵ This paragraph would provide that a broker-dealer dually registered as an SBSD or MSBSP must file proposed Form SBS with the Commission within seventeen business days of the end of the month.⁴²⁶ Thus, the paragraph would require broker-dealer SBSDs and broker-dealer MSBSPs to file proposed Form SBS on a monthly basis. This would be consistent with the plans of the SROs, which generally require carrying broker-dealers and broker-dealers that act as dealers to file the FOCUS Report Part II on a monthly (rather than quarterly) basis.⁴²⁷

The Commission is proposing to include a parallel requirement in paragraph (a)(1) of proposed Rule 18a-7 that is modeled on paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended, that would apply to stand-alone SBSDs and stand-alone MSBSPs.⁴²⁸ Under this

⁴²³ As noted above, the Commission is proposing to redesignate paragraph (a)(2) of Rule 17a-5 as paragraph (a)(1).

⁴²⁴ See paragraphs (a)(1)(ii) and (iii) of Rule 17a-5, as proposed to be amended.

⁴²⁵ See paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended.

⁴²⁶ See *id.*

⁴²⁷ Because this would be a monthly filing requirement, the Commission is not proposing to require broker-dealer SBSDs and broker-dealer MSBSPs to also file proposed Form SBS within 17 business days after the end of the fiscal year of the firm where that date is not the end of a calendar quarter as is required under paragraphs (a)(2)(ii) and (iii) of Rule 17a-5 (which require quarterly filing of the FOCUS Report Part II and Part IIA, respectively). Compare 17 CFR 240.17a-5(a)(2)(ii) and (iii), with paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended.

⁴²⁸ Compare paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended, with paragraph (a)(1) of proposed Rule 18a-7.

paragraph, these registrants would be required to file proposed Form SBS with the Commission or its designee within seventeen business days after the end of each month.⁴²⁹ The reference to a Commission designee is intended to provide the Commission with the option of requiring that these registrants file proposed Form SBS with a third party.⁴³⁰

Paragraph (a)(2) of proposed Rule 18a-7 would apply to bank SBSDs and bank MSBSPs and require these registrants to file proposed Form SBS with the Commission or its designee within seventeen business days after the end of each calendar quarter (instead of each month).⁴³¹ The Commission would require quarterly financial reporting for bank SBSDs and bank MSBSPs, instead of monthly reporting, because the prudential regulators currently require banks to file reports of financial and operational condition known as call reports on a quarterly basis.⁴³² As discussed below in section II.B.3.a. of this release, the information that would be reported by bank SBSDs and bank MSBSPs on proposed Form SBS largely would be information that banks are required to provide in the call reports.

Paragraph (a)(3) of proposed Rule 18a-7 would apply to SBSDs authorized by the Commission to compute net capital using internal models pursuant to paragraph (d) of proposed Rule 18a-1. The Commission would require these registrants to file most of the required documents within 17 business days after the end of each month.⁴³³ However, to correspond with

⁴²⁹ See paragraph (a)(1) of proposed Rule 18a-7.

⁴³⁰ As discussed above, generally all broker-dealers file the FOCUS Report with their SROs rather than directly with the Commission.

⁴³¹ See paragraph (a)(2) of proposed Rule 18a-7.

⁴³² See Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices—FFIEC 031 (“FFIEC Form 031” or “call report”). See also 12 U.S.C. 161; 12 U.S.C. 324; 12 U.S.C. 1464; 12 U.S.C. 1817.

⁴³³ See paragraph (a)(3)(i)-(vii) of proposed Rule 18a-7.

the timing requirement in paragraph (d)(9)(i)(C)(1)-(2) of proposed Rule 18a-1,⁴³⁴ these registrants would be required to file the following reports within seventeen business days after the end of each calendar quarter (instead of each month): a report identifying the number of business days for which actual daily net trading loss exceeded the corresponding daily value at risk ("VaR"); and the results of backtesting of all internal models used to compute allowable capital, indicating the number of backtesting exceptions.⁴³⁵

The Commission also is proposing amendments to paragraphs (a)(1)(ii), (a)(1)(iii), (a)(1)(iv), and (a)(1)(v) of Rule 17a-5 that would make explicit the requirement that the FOCUS Report or Form SBS filed by a broker-dealer must be "executed."⁴³⁶ Additionally, paragraphs (a)(1) and (a)(2) of proposed Rule 18a-7 would contain parallel language requiring that a Form SBS filed by a stand-alone SBSD, stand-alone MSBSP, bank SBSD, or bank MSBSP must be executed.

Finally, as noted above, paragraph (a)(4) of Rule 17a-5 contains an exception from the requirement to file a FOCUS Report directly with the Commission applicable to broker-dealers that are members of a national securities exchange or a registered national securities association if that exchange or association maintains records containing the information required by the FOCUS Report and transmits such information to the Commission pursuant to a plan that has been submitted to, and declared effective by, the Commission.⁴³⁷ The Commission proposes to add a reference to proposed Form SBS to this provision so that SROs could include the filing of

⁴³⁴ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70337.

⁴³⁵ See paragraph (a)(3)(viii)-(ix) of proposed Rule 18a-7.

⁴³⁶ See paragraphs (a)(1)(ii)-(iv) of Rule 17a-5, as proposed to be amended. Part II, Part IIA, Part IIB, and Part II CSE of the FOCUS Report each has a section for the filer to execute the form.

⁴³⁷ See 17 CFR 240.17a-5(a)(4).

Form SBS in their plans.⁴³⁸ If incorporated into the plans, broker-dealer SBSDs and broker-dealer MSBSPs would file proposed Form SBS with their SRO (rather than directly with the Commission). The Commission preliminarily expects that the reporting requirements under an SRO's plan with respect to proposed Form SBS would need to be at least as rigorous as the requirements in paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended, to be declared effective by the Commission.

b. Information Elicited in Form SBS

As discussed above, all categories of SBSDs and MSBSPs would be required to file proposed Form SBS. This form is modeled on the FOCUS Report, particularly the FOCUS Report Part II CSE.⁴³⁹ The FOCUS Report Part II CSE served as the template for designing proposed Form SBS because it is designed to account for the use of internal models by ANC broker-dealers and elicits more detailed information about derivatives positions and exposures than the FOCUS Report Part II and Part IIA.⁴⁴⁰ Based on staff experience, including experience

⁴³⁸ See paragraph (a)(3) of Rule 17a-5, as proposed to be amended. Further, paragraph (a)(5) of Rule 17a-5 requires broker-dealers to file Form Custody (17 CFR 249.1900) with their DEAs within 17 business days after the end of each calendar quarter and within 17 business days after the end of the fiscal year of the broker-dealer where that date is not the end of a calendar quarter. See 17 CFR 240.17a-5(a)(5). The DEA must maintain the information obtained through the filing of Form Custody and must promptly transmit that information to the Commission at such time as it transmits the applicable part of the FOCUS Report pursuant to a plan. See *id.* The Commission is proposing to amend this provision to include a reference to proposed Form SBS to account for the fact that broker-dealer SBSDs and broker-dealer MSBSPs would file proposed Form SBS with their DEAs along with Form Custody (rather than the FOCUS Report) if the SROs incorporate the filing of Form SBS in their plans. See paragraph (a)(4) of Rule 17a-5, as proposed to be amended.

⁴³⁹ Compare proposed Form SBS, with the FOCUS Report Part II CSE.

⁴⁴⁰ The FOCUS Report Part IIB elicits similar information about derivatives positions and exposures but otherwise is more limited than the FOCUS Report Part II CSE because OTC derivatives dealers are permitted to engage in only a narrow range of activities. See 17 CFR 240.3b-12; 17 CFR 240.15a-1. Specifically, Rule 3b-12, defining the term OTC derivatives dealer, provides, among other things, that an OTC derivatives dealer's securities activities must be limited to engaging in dealer activities in eligible OTC derivative instruments (as defined in the rule) that are securities; issuing and reacquiring securities that are issued by the dealer, including warrants on securities, hybrid securities, and structured notes; engaging in cash management securities activities (as defined in Rule 3b-14 (17 CFR 240.3b-14)); engaging in ancillary portfolio management securities activities (as defined in the rule); and engaging in such other securities activities that the Commission designates by order. See 17 CFR 240.3b-12. Rule 15a-1,

monitoring ANC broker-dealers, the Commission anticipates that most SBSDs will use internal models to compute their net capital.⁴⁴¹

The FOCUS Report elicits financial and operational information about a broker-dealer through sections consisting of uniquely numbered line items. The information (e.g., a number or dollar amount) is entered into the line items.⁴⁴² Generally, a line item that is common to Part II, Part IIA, Part IIB, and Part II CSE of the FOCUS Report shares the same unique number, which facilitates aggregating information and comparing reported information across broker-dealers.⁴⁴³ Proposed Form SBS similarly would elicit information about the financial and operational condition of an SBS or MSBSP through sections consisting of uniquely numbered line items. Line items on proposed Form SBS that correspond to line items on the FOCUS Report would share the same unique number and require the entry of the same type of information.⁴⁴⁴ Proposed Form SBS would not include a parallel line item for each line item on the FOCUS Report because not all of the information required on the FOCUS Report is relevant for SBSDs and MSBSPs.⁴⁴⁵ Further, proposed Form SBS would have lines and corresponding line items

governing the securities activities of OTC derivatives dealers, provides that an OTC derivatives dealer must effect transactions in OTC derivatives with most types of counterparties through an affiliated Commission-registered broker-dealer that is not an OTC derivatives dealer. See 17 CFR 240.15a-1.

⁴⁴¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70293.

⁴⁴² As used in this release, the term line refers to the lines in the left column on the FOCUS Report and proposed Form SBS that describe the type of entries to be made on that line. The term line item refers to the fields into which information is entered. For example, Line 1 of the statement of financial condition section on Form SBS is cash and Line Item 200 is the field to enter the dollar amount of cash and Line Item 750 is the field to enter the total dollar amount of cash.

⁴⁴³ For example, Line Item 200 is the field to enter the dollar amount of cash and Line Item 750 is the field to enter the total dollar amount of cash in the statement of financial condition section for each part of the FOCUS Report. The FOCUS Report Part IIB and Part II CSE share certain common sections that have common entries but the line items for the entries are assigned different numbers. Proposed Form SBS would use the numbers assigned to the line items in Part II CSE.

⁴⁴⁴ For example, Line Item 200 is the field to enter the dollar amount of cash and Line Item 750 is the field to enter the total dollar amount of cash in the statement of financial condition section on proposed Form SBS.

that are not on the FOCUS Report. The additional lines and line items would elicit more detail about the security-based swap and swap activities of the SBSD and MSBSP filers.⁴⁴⁶

As discussed below, broker-dealer SBSDs and broker-dealer MSBSPs would be required to report the most information on proposed Form SBS because it would elicit information about their activities as a broker-dealer and as an SBSD or MSBSP. Stand-alone SBSDs and stand-alone MSBSPs would be required to report information similar to that required of broker-dealer SBSDs and broker-dealer MSBSPs. The information elicited from bank SBSDs and bank MSBSPs would: (1) derive largely from the information they report on the call reports; and (2) focus on their business as an SBSD or MSBSP.⁴⁴⁷

Proposed Form SBS is divided into five parts. Part 1 would apply to nonbank SBSDs and nonbank MSBSPs (*i.e.*, broker-dealer SBSDs, broker-dealer MSBSPs, stand-alone SBSDs, and stand-alone MSBSPs) and is similar to the FOCUS Report Part II CSE, but includes additional sections and line items to elicit more detail about security-based swap and swap activities. Part 2 would apply to bank SBSDs and bank MSBSPs and elicit certain financial information that these classes of registrants – as banks – would need to report in the call reports plus certain additional information about security-based swap and swap activities. Part 3 would

⁴⁴⁵ The FOCUS Report Part II CSE has the most line items of the four parts of the FOCUS Report and, consequently, generally will serve as the means of comparing proposed Form SBS with the FOCUS Report for purposes of the discussion in this release. Proposed Form SBS would not include line items from Part II CSE that are obsolete, inapplicable, or redundant of the additional line items on proposed Form SBS. Specifically, proposed Form SBS would not include Line Item 18 (box checked if FOCUS Part II CSE is filed pursuant to Rule 17a-11 under the Exchange Act); Line Item 98 (SEC File No.); Line Item 99 (As of date the for statement of financial condition); Line Item 291 (Derivatives Receivable – Allowable); Line Item 801 (Derivatives Payable – Total); Line Item 3635 (Total Market Risk Exposure); Line Item 3679 (Total Credit Risk Exposure); Line Item 3931 (Number of months included in this statement); Line Item 3932 (For the period from); Line Item 3933 (For the period to); Line Item 4070 (Interest Expense, Includes interest on accounts subject to subordination agreements); and Line Items 5000–5350 (Financial and operational data).

⁴⁴⁶ Line items that are unique to proposed Form SBS are identified on the Form by the number 99, 999, 9999, or 99999 for the purposes of this proposing release.

⁴⁴⁷ See 15 U.S.C. 78o-10(f)(1)(B)(i).

apply to an SBSBSP or MSBSP that is dually registered as an FCM and elicit information about the firm's net capital computation and segregation of customer assets under CFTC rules. Part 4 would apply to nonbank SBSBs and nonbank MSBSPs and elicit detailed information about a firm's security-based swap and swap positions, counterparties, and exposures. Part 5 would apply to bank SBSBs and bank MSBSPs and also elicit detailed information about a firm's security-based swap and swap positions, but on a more limited basis than Part 4.

Proposed Form SBS would have a cover page that largely is in the same format as the cover page of the FOCUS Report, but includes line items to indicate the type of registrant filing Form SBS: (1) a stand-alone SBSB; (2) a stand-alone MSBSP; (3) a broker-dealer SBSB; (4) a broker-dealer MSBSP; (5) a bank MSBSP; or (6) a bank MSBSP. The heading at the top of each remaining page of proposed Form SBS would identify the type of registrant that must enter the information to be reported on the page.

A general description of each Part of proposed Form SBS appears below, including a more detailed description of the components of Form SBS for which there are not parallel components in the FOCUS Report. In addition to proposed Form SBS, the Commission is proposing instructions for Form SBS to provide further guidance on the information to be entered into certain line items.⁴⁴⁸ The instructions are modeled on the instructions to the FOCUS Report Part II, but with more instructions to cover the additional line items and sections that are not on the FOCUS Report Part II.⁴⁴⁹

i. Part 1 of Proposed Form SBS

Part 1 of proposed Form SBS would apply to nonbank SBSBs and nonbank MSBSPs.

⁴⁴⁸ See instructions to proposed Form SBS.

⁴⁴⁹ Compare instructions to proposed Form SBS, with instructions to the FOCUS Report Part II. The instructions to the FOCUS Report Part IIA are available at http://www.sec.gov/about/forms/formx-17a-5_2a.pdf.

This part of Form SBS is modeled on the FOCUS Report, particularly the FOCUS Report Part II CSE, but includes additional sections and line items to report more detail about security-based swap and swap activities.⁴⁵⁰ Like the FOCUS Report Part II CSE, Part 1 of proposed Form SBS would require the filer to enter information into the following sections, as applicable: (1) a statement of financial condition;⁴⁵¹ (2) a computation of net capital;⁴⁵² (3) a computation of minimum net capital required;⁴⁵³ (4) a statement of income (loss);⁴⁵⁴ (5) a statement of capital withdrawals, a statement of changes in ownership equity, and a statement of changes in liabilities

⁴⁵⁰ Compare Part 1 proposed Form SBS, with the FOCUS Report Part II CSE. As discussed below, the FOCUS Report has a number of sections that are common to all the parts thereof. Generally, a section on the FOCUS Report Part II CSE elicits information that is as detailed, if not more detailed, than the parallel section on the FOCUS Report Part II, Part IIA, or Part IIB.

⁴⁵¹ Each part of the FOCUS Report has a section to provide a statement of financial condition that elicits detail about the assets, liabilities and ownership equity of the broker-dealer. Part 1 of proposed Form SBS similarly has a section to provide a statement of financial condition. See Part 1 of proposed Form SBS, Statement of Financial Condition. This section would need to be completed by nonbank SBSs and nonbank MSBSPs. As discussed below, the statement of financial condition section on proposed Form SBS has additional line items that are not on the FOCUS Report.

⁴⁵² Each part of the FOCUS Report has a section to provide a computation of net capital under Rule 15c3-1. Part 1 of proposed Form SBS similarly has sections to provide a computation of net capital that would need to be completed by nonbank SBSs (i.e., broker-dealer SBSs and stand-alone SBSs) and broker-dealer MSBSPs (all of which would be subject to a net capital rule). See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Authorized to use Models) and Computation of Net Capital (Filer Not Authorized to use Models). As discussed below, proposed Form SBS has two net capital computation sections: one for firms that are authorized to use models and one for firms that are not authorized to use models. Further, these sections have additional line items that are not on the FOCUS Report.

⁴⁵³ Each part of the FOCUS Report has a section to provide a computation of minimum required net capital under Rule 15c3-1. Part 1 of proposed Form SBS similarly has sections to provide a required minimum net capital computation that would need to be completed by nonbank SBSs and broker-dealer MSBSPs. See Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Broker-Dealer) and Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer). As discussed below, proposed Form SBS has two minimum net capital computation sections: one for broker-dealer filers (i.e., broker-dealer SBSs and broker-dealer MSBSPs) and one for stand-alone SBSs. Further, these sections have additional line items that are not on the FOCUS Report.

⁴⁵⁴ Each part of the FOCUS Report has a section to provide a statement of income (loss) that elicits detail about the revenue and expenses of the broker-dealer during the reporting period. Part 1 of proposed Form SBS similarly has a statement of income (loss) section that would need to be completed by nonbank SBSs and nonbank MSBSPs. See Part 1 of proposed Form SBS, Statement of Income (Loss). As discussed below, the statement of income (loss) section on proposed Form SBS is modeled on a supplemental statement of income form promulgated by FINRA. The proposed Form SBS section has additional line items that are not on FINRA's form.

subordinated to claims of creditors;⁴⁵⁵ (6) certain financial and operational data;⁴⁵⁶ (7) a customer reserve account computation under Rule 15c3-3;⁴⁵⁷ (8) information for possession or control

⁴⁵⁵ The FOCUS Report Part II, Part IIB, and Part II CSE have sections to provide a statement of capital withdrawals, a statement of changes in ownership equity, and a statement of changes in liabilities subordinated to claims of general creditors. The FOCUS Report Part IIA has sections to provide a statement of changes in ownership equity and a statement of changes in liabilities subordinated to claims of general creditors. In the statement of capital withdrawals section, a broker-dealer must report information about the firm's ownership equity and subordinated liabilities maturing or proposed to be withdrawn within the next six months and accruals that have not been deducted in the computation of net capital. In the statements of changes in ownership equity and liabilities subordinated to claims of general creditors sections, a broker-dealer must report the amount of such equity and liability balances, respectively, as of the beginning of the reporting period and as of the end of the reporting period and provide detail with respect to changes in the balances. The information reported in all these statements is designed to assist securities regulators in monitoring the financial condition of the broker-dealer and the firm's compliance with the net capital rule. For example, under Rule 15c3-1, broker-dealers are subject to debt-to-equity ratio requirements, limitations governing the withdrawal of equity capital, and requirements with respect to subordinated loans that qualify to be added back to net worth when computing net capital. See 17 CFR 240.15c3-1d ; 17 CFR 240.15c3-3(d) and (e). Nonbank SBSDs and broker-dealer MSBSPs would be subject to similar requirements and limitations. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70254–70256. Consequently, Part 1 of proposed Form SBS has sections to provide a statement of capital withdrawals, a statement of changes in ownership equity, and a statement of changes in liabilities subordinated to claims of creditors that would need to be completed by nonbank SBSDs and broker-dealer MSBSPs. See Part 1 of proposed Form SBS, Capital Withdrawals and Capital Withdrawals Recap. These sections on proposed Form SBS have the same line items as the parallel sections on the FOCUS Report Part II CSE and there are no additional line items.

⁴⁵⁶ Each part of the FOCUS Report has a section to report certain financial and operational data. The FOCUS Report Part II CSE has additional sections to report operational charges deducted from net capital under Rule 15c3-1 and potential operational charges. Broker-dealers must report information on these sections about, among other things, the number of income and non-income producing personnel, fails, security concentrations, lease and rentals payables, money suspense and balancing differences, and securities differences. Certain of these items – including securities differences – result in charges when computing net capital. See 17 CFR 240.15c3-1(c)(2)(v). Securities regulators use this information to monitor, among other things, whether the broker-dealer is processing securities transactions in a timely manner and properly accounting for the securities it holds. Part 1 of proposed Form SBS similarly has sections to report this type of financial and operational data that would need to be completed by nonbank SBSDs and broker-dealer MSBSPs. See Part 1 of proposed Form SBS, Financial and Operational Data. The sections of the form have the same line items as the parallel sections in the FOCUS Report Part II CSE and there are no additional line items.

⁴⁵⁷ The FOCUS Report Part II and Part II CSE have a section to provide a computation of the customer reserve requirement under Rule 15c3-3. As discussed above in section II.A.2.a. of this release, Rule 15c3-3 requires a carrying broker-dealer to maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers. See 17 CFR 240.15c3-3(e). The amount of net cash owed to customers is computed pursuant to a formula set forth in Exhibit A to Rule 15c3-3. See 17 CFR 240.15c3-3a. Part 1 of proposed Form SBS similarly has a section to provide a computation of the customer reserve requirement under Rule 15c3-3 that would need to be completed by broker-dealer SBSDs and broker-dealer MSBSPs that hold funds and securities for customers that are not security-based swap customers. See Part 1 of proposed Form SBS, Computation for Determination of Reserve Requirements. This section has the same line items as the parallel section on the FOCUS Report Part II CSE and there are no additional line items. Further, as discussed below, proposed Form SBS has a section to provide a separate computation for the security-based swap customer reserve account

requirements under Rule 15c3-3;⁴⁵⁸ and (9) a computation for the determination of reserve requirements for proprietary accounts of broker-dealers ("PAB").⁴⁵⁹ Part 1 of proposed Form SBS includes additional line items in certain of these sections to elicit more detail about security-

requirement under proposed Rule 18a-4. In addition, the FOCUS Report Part IIA has a section to claim an exemption under Rule 15c3-3. In this section, a broker-dealer claiming an exemption under Rule 15c3-3 must identify whether it is relying on paragraph (k)(1), (k)(2)(A), (k)(2)(B), or (k)(3) of Rule 15c3-3. Part 1 of proposed Form SBS similarly has a section in which a broker-dealer SBSD or broker-dealer MSBSP could claim an exemption from Rule 15c3-3. See Part 1 of proposed Form SBS, Exemptive Provision under Rule 15c3-3.

⁴⁵⁸ The FOCUS Report Part II and Part II CSE have a section to report information relating to the possession or control requirement under Rule 15c3-3. As discussed above in section II.A.2.a. of this release, Rule 15c3-3 requires a carrying broker-dealer to maintain physical possession or control over customers' fully paid and excess margin securities. See 17 CFR 240.15c3-3(d). Physical possession or control means the carrying broker-dealer must hold these securities in one of several locations specified in Rule 15c3-3 and free of liens or any other interest that could be exercised by a third party to secure an obligation of the broker-dealer. See 17 CFR 240.15c3-3(c). Part 1 of proposed Form SBS similarly has a section to report the same information about the possession or control requirement under Rule 15c3-3 as is required in the FOCUS Report Part II and Part II CSE. See Part 1 of proposed Form SBS, Computation for Determination of Reserve Requirements. This section would need to be completed by broker-dealer SBSDs and broker-dealer MSBSPs that hold funds and securities for customers that are not security-based swap customers. This section has the same line items as the parallel section on the FOCUS Report Part II CSE and there are no additional line items. Further, as discussed below, proposed Form SBS has a section to report the same type of information about the possession or control requirement relating to security-based swap customers under proposed Rule 18a-4.

⁴⁵⁹ The FOCUS Report Part II CSE has a section to provide the computation of the reserve requirement for proprietary accounts of broker-dealers. This computation is a result of a broker-dealer not being a customer as that term is defined in Rule 15c3-3. See 17 CFR 240.15c3-3(a)(1). Accordingly, a carrying broker-dealer that holds the account of another broker-dealer is not required to maintain possession or control of the fully paid and excess margin securities of the other the broker-dealer or include credit and debit items associated with the account of the other broker-dealer in its customer reserve computation. The absence of a requirement to protect the other broker-dealer's cash under Rule 15c3-3 raised a question of whether the other broker-dealer could treat cash held by the carrying broker-dealer as an allowable asset under Rule 15c3-1. In response, the Commission staff issued a no-action letter stating that the staff would not recommend enforcement action to the Commission if a broker-dealer treated cash held by another broker-dealer as an allowable asset under Rule 15c3-1, provided the other broker-dealer agreed to: (1) perform a reserve computation for broker-dealer accounts; (2) establish a separate special reserve bank account, and; (3) maintain cash or qualified securities in the reserve account equal to the computed reserve requirement. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Raymond J. Hennessy, Vice President, NYSE, and Thomas Cassella, Vice President, NASD regulation, Inc. (Nov. 10, 1998). The Commission recently codified this letter through amendments to Rule 15c3-3. See Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013); 78 FR 51824 (Aug. 21, 2013). Part 1 of proposed Form SBS similarly has a section to provide a computation of PAB reserve requirements. See Part 1 of proposed Form SBS, Computation for Determination of PAB Requirements. This section would need to be completed by broker-dealer SBSDs and broker-dealer MSBSPs. The section has the same line items as the parallel section on the FOCUS Report Part II CSE and there are no additional line items.

based swap and swap activities.⁴⁶⁰ Further, Part 1 has the following additional sections: (1) a computation of tangible net worth under proposed Rule 18a-2;⁴⁶¹ (2) a reserve account computation under proposed Rule 18a-4;⁴⁶² and (3) information for possession or control requirements under proposed Rule 18a-4.⁴⁶³ The additional line items and sections are discussed below.

Statement of Financial Condition

The line items in the statement of financial condition section on proposed Form SBS are largely the same line items in the statement of financial condition section on the FOCUS Report Part II CSE.⁴⁶⁴ However, as discussed below, the proposed Form SBS section has additional line items that are not in the Part II CSE section.

First, a broker-dealer must enter detail in the FOCUS Report Part II CSE section about the dollar amount of receivables from other broker-dealers and clearing organizations.⁴⁶⁵ The

⁴⁶⁰ As noted above, additional line items are identified on proposed Form SBS by the number 99, 999, 9999, or 99999 for the purposes of this proposing release.

⁴⁶¹ Proposed Rule 18a-2 would require stand-alone MSBSPs to maintain positive tangible net worth. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70256–70257. Under proposed Rule 18a-2, tangible net worth would be defined to mean the MSBSP's net worth as determined in accordance with generally accepted accounting principles in the U.S., excluding goodwill and other intangible assets.

⁴⁶² As discussed above in section II.A.2.a. of this release, proposed Rule 18a-4 would require an SBSD, among other things, to maintain a security-based swap customer reserve account at a bank separate from any other bank account of the SBSD. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70282–70287. Further, it would provide that the SBSD must at all times maintain in the security-based swap customer reserve account cash and/or qualified securities in amounts computed daily in accordance with Exhibit A to proposed Rule 18a-4. See id.

⁴⁶³ As discussed above in section II.A.2.a. of this release, proposed Rule 18a-4 would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70278–70282.

⁴⁶⁴ Compare Part 1 of proposed Form SBS, Statement of Financial Condition, with the FOCUS Report Part II CSE, Statement of Financial Condition.

⁴⁶⁵ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 3A–3E.

detail includes the amount of such receivables includible in the reserve computation under Rule 15c3-3.⁴⁶⁶ The proposed Form SBS section requires the same detail about these receivables.⁴⁶⁷ Additionally, it requires detail about the dollar amount of the receivables includible in the reserve computation under proposed Rule 18a-4.⁴⁶⁸

Second, a broker-dealer must enter detail in the FOCUS Report Part II CSE section about the dollar amount of payables to other broker-dealers and clearing organizations.⁴⁶⁹ The detail includes the amount of such payables includible in the reserve computation under Rule 15c3-3.⁴⁷⁰ The proposed Form SBS section requires the same detail about these payables.⁴⁷¹ Additionally, it requires detail about the dollar amount of the payables includible in the reserve computation under proposed Rule 18a-4.⁴⁷²

Third, a broker-dealer must enter detail in the FOCUS Report Part II CSE section about the dollar amount of payables to securities and commodities customers.⁴⁷³ The broker-dealer also must provide the dollar amount of the payable to securities customers representing free credit balances.⁴⁷⁴ The proposed Form SBS section requires the same detail about payables to securities and commodities customers.⁴⁷⁵ Additionally, it requires detail about the dollar amount

⁴⁶⁶ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 3A1, 3B1, 3C1, and 3D1.

⁴⁶⁷ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 3A–3E.

⁴⁶⁸ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 3A2, 3B2, 3C2, and 3D2. As discussed in section II.A.2.a. of this release, proposed Rule 18a-4 is modeled on Rule 15c3-3. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70274–70288.

⁴⁶⁹ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 21A–21E.

⁴⁷⁰ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 21A1, 21B1, 21C1, and 21D1.

⁴⁷¹ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 20A–20E.

⁴⁷² See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 20A2, 20B2, 20C2, and 20D2.

⁴⁷³ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 22A–22B.

⁴⁷⁴ See FOCUS Report Part II CSE, Line Item 950.

⁴⁷⁵ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 21A–21B.

of payables to security-based swap customers, including the amount of the payables representing free credits, and the amount of payables to swap customers.⁴⁷⁶

Fourth, a broker-dealer must enter into the FOCUS Report Part II CSE section the dollar amount of payables to securities and commodities non-customers.⁴⁷⁷ The proposed Form SBS section requires the entry of the same information.⁴⁷⁸ Additionally, it requires the entry of the dollar amount of the payables to security-based swap and swap non-customers.⁴⁷⁹

Computation of Net Capital

Nonbank SBSDs and broker-dealer MSBSPs would need to complete a computation of net capital section on proposed Form SBS.⁴⁸⁰ Unlike the FOCUS Report Part II CSE, there are two sections on proposed Form SBS: one applicable to filers that are authorized to use internal models; and one applicable to filers that are not authorized to use internal models.⁴⁸¹

Computation for Filers Authorized to use Models. The line items in the net capital computation section on proposed Form SBS applicable to filers authorized to use models are largely the same line items in the computation of net capital section on the FOCUS Report Part II

⁴⁷⁶ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 21C–21D.

⁴⁷⁷ See FOCUS Report Part II CSE, Statement of Financial Condition, Lines 23A–23B.

⁴⁷⁸ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 22A–22B.

⁴⁷⁹ See Part 1 of proposed Form SBS, Statement of Financial Condition, Lines 22C–22D.

⁴⁸⁰ Broker-dealer SBSDs and broker-dealer MSBSPs – as broker-dealers – would be subject to Rule 15c3-1 and, therefore, would be required to compute net capital as that term is defined in the rule. See 17 CFR 240.15c3-1(c)(2). Stand-alone MSBSPs would be subject to a tangible net worth capital standard pursuant to proposed Rule 18a-2, and therefore, would not compute net capital. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70256–70257. The Commission has proposed that stand-alone SBSDs be subject to a net capital requirement in proposed Rule 18a-1 that is modeled on Rule 15c3-1. See id. at 70217–70257. Under proposed Rule 18a-1, stand-alone SBSDs would be required to compute net capital as defined in proposed Rule 18a-1. See id. The definition in proposed Rule 18a-1 is modeled on the definition in Rule 15c3-1 and, consequently, proposed Form SBS does not have separate net capital computation sections for broker-dealer filers and stand-alone SBSd filers.

⁴⁸¹ All broker-dealers that file the FOCUS Report Part II CSE have been approved to use models. Accordingly, it does not need to have a computation for broker-dealers not approved to use models.

CSE.⁴⁸² However, as discussed below, the proposed Form SBS section has additional line items that are not on the FOCUS Report Part II CSE section.

First, a broker-dealer must enter detail in the Part II CSE section about deductions and other charges that the firm must subtract from net worth, including the total dollar amount of non-allowable assets from the Statement of Financial Condition.⁴⁸³ The detail includes charges for under-margined securities accounts of customers and non-customers,⁴⁸⁴ and under-margined accounts of commodities customers and non-customers.⁴⁸⁵ The proposed Form SBS section would require the same detail about these deductions.⁴⁸⁶ In addition, the section would require detail about the amount of deductions for under-margined accounts of security-based swap customers and non-customers,⁴⁸⁷ and under-margined accounts of swap customers and non-

⁴⁸² Compare Part I of proposed Form SBS, Computation of Net Capital (Filer Authorized to Use Models), with FOCUS Report Part II CSE, Computation of Net Capital.

⁴⁸³ See FOCUS Report Part II CSE, Computation of Net Capital, Line 6A.

⁴⁸⁴ See FOCUS Report Part II CSE, Computation of Net Capital, Line 6A1. Paragraph (c)(2)(xii) of Rule 15c3-1 requires a broker-dealer to deduct the amount of cash required in each customer's or non-customer's account to meet the maintenance margin requirements of the DEA for the broker-dealer, after application of calls for margin, marks to the market or other required deposits which are outstanding five business days or less. See 17 CFR 240.15c3-1(c)(2)(xii). Broker-dealers are subject to maintenance margin requirements in rules promulgated by their DEAs. See, e.g., FINRA Rules 4210 through 4240.

⁴⁸⁵ See FOCUS Report Part II CSE, Computation of Net Capital Line 6A2. Paragraphs (a)(3)(xii) and (a)(3)(xiii) of Appendix B to Rule 15c3-1 prescribe capital deductions for under-margined customer and non-customer commodity accounts. See 17 CFR 240.15c3-1b(a)(3)(xii) and (xiii).

⁴⁸⁶ See Part I of proposed Form SBS, Computation of Net Capital (Filer Authorized to Use Models), Lines 6A1-6A2.

⁴⁸⁷ See Part I of proposed Form SBS, Computation of Net Capital (Filer Authorized to Use Models), Line 6A3. The Commission has proposed that nonbank SBSBs be required to deduct the amount of cash required in the account of each security-based swap customer to meet the margin requirements of a clearing agency, DEA, or the Commission, after application of calls for margin, marks to the market, or other required deposits which are outstanding one business day or less and to take certain capital charges in lieu of collecting margin from certain types of entities or with respect to certain types of accounts. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70245-70248. In addition, as discussed above in section II.A.2.a. of this release, the Commission has proposed margin requirements for nonbank SBSBs and nonbank MSBSPs with respect to non-cleared security-based swaps. See id. at 70257-70274. Security-based swap clearing agencies require their clearing members to post margin for proprietary and customer positions of the member cleared by the clearing agency. See Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-

customers.⁴⁸⁸

Second, an ANC broker-dealer must provide detail on a schedule to the FOCUS Report Part II CSE about the credit risk charges it takes as part of its capital computation.⁴⁸⁹ Specifically, the FOCUS Report Part II CSE schedule requires the ANC broker-dealer to provide detail with respect to the three components of the credit risk charge, namely: (1) the aggregate counterparty exposure charge; (2) the aggregate counterparty concentration charge; and (3) the portfolio concentration charge.⁴⁹⁰ Proposed Form SBS would require the same detail about these components of the credit risk charge but require that it be reported in the net capital computation section rather than on a separate schedule.⁴⁹¹ The proposed Form also would require additional

Regulatory Organizations, Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602, 41603 (July 13, 2012). They also may require their clearing members to collect margin from their security-based swap customers. See id.

⁴⁸⁸ See Part 1 of proposed Form SBS, Computation of Net Capital (Authorized to Use Models), Line 6A4. Derivatives clearing organizations require their clearing members to post margin for proprietary and customer swaps positions of the member cleared by the clearing organization. See Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, 77 FR at 41603. They also may require their clearing members to collect margin from their swaps customers. See id.

⁴⁸⁹ See FOCUS Report Part II CSE, Schedule 1 – FINRA Supplementary Capital Information, Lines 6A–6C. As discussed above in section II.B.3.a. of this release, ANC broker-dealers are permitted to add back to net worth uncollateralized receivables from counterparties arising from OTC derivatives transactions when computing net capital. See 17 CFR 240.15c3-1e(c). Instead of the 100% deduction that applies to most unsecured receivables under Rule 15c3-1, ANC broker-dealers are permitted to take the credit risk charge. See 17 CFR 240.15c3-1(a)(7); 17 CFR 240.15c3-1e(c).

⁴⁹⁰ See Part II CSE, Schedule 1 – FINRA Supplementary Capital Information, Lines 6A–6C.

⁴⁹¹ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Authorized to Use Models), Lines 15A–15C. As discussed above in section II.B.3.a. of this release, the Commission has proposed that ANC broker-dealers be permitted to add back to net worth uncollateralized receivables and take the corresponding credit risk charge but only with respect to receivables from counterparties that are commercial end users as that term would be defined in proposed amendments to Rule 15c3-1 and only with respect to security-based swaps. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70240–70245. In addition, the proposed capital requirements for ANC broker-dealer SBSDs and stand-alone ANC SBSDs similarly would allow these registrants to take credit risk charges with respect to uncollateralized receivables but only from commercial end users arising from security-based swaps. See id. Under these proposals, the firms would take a credit risk charge that consists of the three components identified above: (1) a counterparty exposure charge; (2) a concentration charge if the current exposure to a single counterparty exceeds certain thresholds; and (3) a portfolio concentration charge if aggregate current exposure to all counterparties exceeds certain thresholds. See id.

detail about the first component of the credit risk charge: the counterparty exposure charge.⁴⁹² Under the proposed capital requirements for nonbank SBSDs, a firm authorized to use models would need to calculate a counterparty exposure charge for a commercial end user in the same manner as an ANC broker-dealer.⁴⁹³ Specifically, the exposure charge for a commercial end user that is insolvent, in a bankruptcy proceeding, or in default of an obligation on its senior debt would be the net replacement value of the security-based swaps with the end user.⁴⁹⁴ The counterparty exposure charge for all other commercial end users would be the credit equivalent amount of the firm's exposure to the end user multiplied by an applicable credit risk weight factor and then multiplied by 8%.⁴⁹⁵ Proposed Form SBS would have line items to enter the aggregate counterparty exposure charge for these two categories of commercial end users (*i.e.*, (1) end users that are insolvent, in a bankruptcy proceeding, or in default of an obligation on their senior debt; and (2) all other end users and to enter the sum of the two categories).⁴⁹⁶

Computation for filers not authorized to use models. The line items in the net capital computation section on proposed Form SBS applicable to filers not authorized to use models are largely the same line items in the computation of net capital section on the FOCUS Report Part

⁴⁹² See Part 1 of proposed Form SBS, Computation of Net Capital (Authorized to Use Models), Line 15A.

⁴⁹³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70240-70245.

⁴⁹⁴ See *id.*

⁴⁹⁵ See *id.* The credit equivalent amount is the sum of the firm's: (1) maximum potential exposure ("MPE") to the commercial end user multiplied by a backtesting determined factor; and (2) current exposure to the commercial end user. The MPE amount would be a charge to address potential future exposure and would be calculated using the firm's VaR model as applied to the commercial end user's positions after giving effect to a netting agreement with the end user, taking into account collateral received from the end user, and taking into account the current replacement value of the end user's positions. See *id.* The current exposure amount would be the current replacement value of the commercial end user's positions after giving effect to a netting agreement with the counterparty and taking into account collateral received from the counterparty. See *id.*

⁴⁹⁶ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Authorized to Use Models), Lines 15A, 15A1, and 15A2.

II.⁴⁹⁷ However, as discussed below, the proposed Form SBS section has additional line items that are not in the Part II section.

First, as discussed above, the computation section applicable to filers authorized to use models includes line items to enter charges with respect to under-margined security-based swap and swap accounts. The computation section applicable to filers not authorized to use models similarly would require detail about the amount of charges relating to under-margined accounts of security-based swap customers and non-customers,⁴⁹⁸ and under-margined accounts of swap customers and non-customers.⁴⁹⁹

Second, a broker-dealer that is not authorized to use models is required to enter in the FOCUS Report Part II net capital computation section detail about the dollar amount of the standardized haircuts it takes on various categories of proprietary securities positions.⁵⁰⁰ The proposed Form SBS section requires the same detail about standardized haircuts.⁵⁰¹ The section also requires additional entries for the amount of the standardized haircuts applied to security-based swap⁵⁰² and swap positions.⁵⁰³

⁴⁹⁷ Compare Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), with the FOCUS Report Part II, Computation of Net Capital. The FOCUS Report Part II is used by broker-dealers that have not been approved to use internal models as part of their net capital computation.

⁴⁹⁸ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), Line 6A3.

⁴⁹⁹ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), Line 6A4.

⁵⁰⁰ See FOCUS Report Part II, Computation of Net Capital, Lines 9A–9E.

⁵⁰¹ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), Lines 9A–9E.

⁵⁰² See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), Line 10. The proposed capital rules for nonbank SBSs would prescribe standardized haircuts for security-based swaps. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70231–70237.

⁵⁰³ See Part 1 of proposed Form SBS, Computation of Net Capital (Filer Not Authorized to Use Models), Line 11. The proposed capital rules for nonbank SBSs would prescribe standardized haircuts for swaps. See

Computation of Minimum Regulatory Capital Requirements

Proposed Form SBS has two sections for computing minimum required net capital: one for broker-dealer filers (i.e., broker-dealer SBSDs and broker-dealer MSBSPs) and one for stand-alone SBSDs.⁵⁰⁴ As discussed above in section II.A.3.a. of this release, Rule 15c3-1, as proposed to be amended, and proposed Rule 18a-1 would prescribe minimum net capital requirements applicable to nonbank SBSDs as the greater of a fixed-dollar amount and a ratio amount.⁵⁰⁵ The ratio amount applicable to a broker-dealer SBSD would be the sum of the current ratio amount prescribed in Rule 15c3-1 (the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of aggregate debit items ratio) and an amount equal to the 8% margin factor.⁵⁰⁶ The ratio amount applicable to a stand-alone SBSD would be an amount equal solely to the 8% margin factor.⁵⁰⁷ Because the minimum net capital requirement computation that would be applicable to a broker-dealer filer differs from the computation that would be applicable to a stand-alone SBSD, proposed Form SBS would contain a separate section for each type of filer. The line items in the minimum net capital requirement section on proposed Form SBS applicable to broker-dealer filers are largely the same line items in the minimum net capital requirement

Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70248–70250.

⁵⁰⁴ See Part 1 of proposed Form SBS, Broker-Dealer Computation of Minimum Regulatory Capital Requirements and Non-Broker-Dealer Computation of Minimum Regulatory Capital Requirements. As noted above, broker-dealer MSBSPs – as broker-dealers – would be subject to Rule 15c3-1, and therefore would be subject to a minimum net capital requirement. See 17 CFR 140.15c3-1(a). Stand-alone MSBSPs would be subject to a tangible net worth standard pursuant to proposed Rule 18a-2, and therefore would not be subject to a minimum net capital requirement. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70256–70257.

⁵⁰⁵ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70221–70229.

⁵⁰⁶ See id.

⁵⁰⁷ See id. Neither the 15-to-1 aggregate indebtedness to net capital ratio nor the 2% of aggregate debit items ratio would apply to stand-alone SBSDs. See id.

section on the FOCUS Report Part II.⁵⁰⁸ The computation section applicable to stand-alone SBSDs is a substantially scaled down version of the parallel FOCUS Report Part II section. As discussed below, both sections on proposed Form SBS have additional line items that are not on the Part II section.

First, both sections require the entry of detail about the amount of excess tentative net capital held by the firm.⁵⁰⁹ The proposed capital requirements for nonbank SBSDs prescribe minimum tentative net capital requirements for ANC broker-dealer SBSDs and stand-alone ANC SBSDs.⁵¹⁰ These filers would need to indicate in proposed Form SBS: (1) the amount of tentative net capital they maintain; (2) their minimum tentative net capital requirement;⁵¹¹ (3) their excess tentative net capital;⁵¹² and (4) the amount of tentative net capital in excess of 120% of their minimum tentative net capital requirement.⁵¹³

⁵⁰⁸ Compare Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Broker-Dealer), with the FOCUS Report Part II, Computation of Basic Net Capital Requirement, Computation of Aggregate Indebtedness, Computation of Alternate Net Capital Requirement, and Other Ratios.

⁵⁰⁹ See Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Broker-Dealer), Lines 1-4; Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer), Lines 1-4.

⁵¹⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70226-70227. Tentative net capital would be the amount of net capital maintained by the firm before applying standardized haircuts or using internal models to determine deductions on the mark-to-market value of proprietary positions to arrive at the broker-dealer's amount of net capital. See *id.* The minimum tentative net capital requirement is designed to account for the fact that VaR models, while more risk sensitive than standardized haircuts, tend to substantially reduce the amount of the deductions to tentative net capital in comparison to the standardized haircuts because the models recognize more offsets between related positions (*i.e.*, positions that show historical correlations) than the standardized haircuts. See *id.*

⁵¹¹ Under the proposed capital requirements, an ANC broker-dealer SBSD would be required to maintain minimum tentative net capital of \$5 billion and a stand-alone ANC SBSD would be required to maintain minimum tentative net capital of \$100 million. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70226-70227.

⁵¹² The amount of excess tentative net capital would be the amount that the tentative net capital exceeds the amount of required tentative net capital.

⁵¹³ As discussed below in section II.C.2. of the release, Rule 17a-11, as proposed to be amended, and proposed Rule 18a-8 would require an ANC broker-dealer SBSD and a stand-alone ANC SBSD to file a regulatory notice if the firm's tentative net capital falls below 120% of its required minimum tentative net capital.

Second, both sections would have line items to enter the amount of the 8% margin factor. As discussed above, the minimum net capital requirement for a nonbank SBSB would be the greater of a fixed-dollar amount and a ratio amount. The ratio amount for a broker-dealer SBSB would be the sum of the existing ratio requirement and the 8% margin factor. Consequently, the computation section for broker-dealer filers has line items to enter amounts for (as applicable): (1) the 15-to-1 aggregate indebtedness to net capital ratio; (2) the 2% of aggregate debit items ratio; and (3) the 8% margin factor.⁵¹⁴ The section for stand-alone SBSBs has a line item to enter the 8% margin factor.⁵¹⁵

Third, a broker-dealer must provide detail in the FOCUS Report Part II CSE section about the dollar amount of net capital in excess of the greater of: (1) 5% of combined aggregate debit items; and (2) 120% of the firm's minimum net capital requirement.⁵¹⁶ The proposed Form SBS sections would require a broker-dealer SBSB, broker-dealer MSBSP, and stand-alone SBSB to enter the amount of net capital in excess of 120% of the minimum net capital requirement.⁵¹⁷

⁵¹⁴ See Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Broker-Dealer), Lines 4A-4C.

⁵¹⁵ See Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer), Line 4.

⁵¹⁶ See FOCUS Report Part II CSE, Computation of Net Capital Requirement, Line 15. As discussed below in section II.C.2. of the release, Rule 17a-11 requires a broker to give notification when its net capital falls below 5% of aggregate debit items and when its net capital falls below 120% of the minimum net capital requirement. See 17 CFR 240.17a-11(c)(2)-(3).

⁵¹⁷ See Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Broker-Dealer), Line 9A. See also Part 1 of proposed Form SBS, Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer), Line 9A. As noted above, Rule 17a-11 requires a broker dealer to give notification when its net capital computation performed pursuant to Rule 15c3-1 shows that its total net capital is less than 120% of the broker-dealer's required minimum net capital. See 17 CFR 240.17a-11(c)(3). As discussed below in section II.C.2. of the release, proposed Rule 18a-8 would require a stand-alone SBSB to notify the Commission when its net capital computation shows that its total net capital is less than 120% of the SBSB's required minimum net capital.

Statement of Income (Loss)

FINRA has adopted Form SSOI with the Commission's approval "to magnify the data from the Statement of Income (Loss) page of the FOCUS Report."⁵¹⁸ The statement of income (loss) section on proposed Form SBS is modeled on Form SSOI and uses the same line items to report information about categories of revenues and expenses.⁵¹⁹ However, as discussed below, the proposed Form SBS section has additional line items that are not on Form SSOI.

First, a broker-dealer is required to enter into Form SSOI detail about the amount of revenue attributable to fees or commissions with respect to various categories of securities.⁵²⁰ The statement of income (loss) section on proposed Form SBS would require a nonbank SBS or nonbank MSBSP to enter the same information.⁵²¹ In addition, the section would elicit information about commissions and fees attributable to security-based swaps, mixed swaps, and swaps.⁵²²

Second, a broker-dealer is required to enter into Form SSOI detail about the amount of revenue attributable to gains or losses on principal trades with respect to various categories of financial instruments, including security-based swaps and swaps.⁵²³ The statement of income

⁵¹⁸ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified By Amendment No. 2, Adopting FINRA Rule 4524 (Supplemental FOCUS Information) and Proposed Supplementary Schedule to the Statement of Income (Loss) Page of FOCUS Reports, Exchange Act Release No. 66364 (Feb. 9, 2012), 77 FR 8938 (Feb. 15, 2012). (Form SSOI "is intended to capture more granular detail of a firm's revenue and expense information. The lack of more specific revenue and expense categories for certain business activities on the Statement of Income (Loss) Page has led many firms to report much of their revenue and expenses as 'other' (miscellaneous), a very general categorization that provides FINRA limited visibility into revenue and expense trends.") Form SSOI is available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/industry/p125702.pdf>.

⁵¹⁹ Compare Part 1 of proposed Form SBS, Statement of Income (Loss), with Form SSOI.

⁵²⁰ See FINRA Form SSOI, Lines 1A-1M.

⁵²¹ See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 1A-1P.

⁵²² See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 1M-1O.

⁵²³ See FINRA Form SSOI, Lines 5A-5O.

(loss) section on proposed Form SBS would require an SBSD or MSBSP to enter the same information, except that it would require additional detail about gains or losses with respect to security-based swaps and swaps.⁵²⁴ Specifically, the section would require entries for gains and losses with respect to the following categories of security-based swaps: (1) debt security-based swaps (other than credit default swaps); (2) equity security-based swaps, (3) credit default swaps; and (4) other security-based swaps.⁵²⁵ It further would require entries for gains and losses with respect to mixed swaps⁵²⁶ and the following categories of swaps: (1) interest rate swaps; (2) foreign exchange swaps; (3) commodity swaps; (4) debt index swaps (other than credit default swaps); (5) equity index swaps; (6) credit default swaps; and (7) other swaps.⁵²⁷

Third, a broker-dealer is required to enter into the statement of income (loss) section on the FOCUS Report Part II detail about the amount of gains or losses on the firm's securities investment accounts.⁵²⁸ Specifically, the section requires: (1) the dollar amount of the realized gains or losses; (2) the dollar amount of the unrealized gains or losses; and (3) the total dollar amount of the gains or losses.⁵²⁹ Form SSOI requires the total dollar amount of gains or losses on firm investments but not the detail on the realized and unrealized gains or losses that must be reported on the FOCUS Report Part II.⁵³⁰ The statement of income (loss) section on proposed Form SBS would require an SBSD or MSBSP to report the same detail about capital gains and losses on investment accounts as the FOCUS Report Part II.⁵³¹

⁵²⁴ See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 5A–5P.

⁵²⁵ See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 5L1–5L4.

⁵²⁶ See Part 1 of proposed Form SBS, Statement of Income (Loss), Line 5M.

⁵²⁷ See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 5N1–5N7.

⁵²⁸ See FOCUS Report Part II Lines 3a–3c.

⁵²⁹ See *id.*

⁵³⁰ See FINRA Form SSOI, Line 6.

⁵³¹ See Part 1 of proposed Form SBS, Statement of Income (Loss), Lines 6A–6C.

Computation of Tangible Net Worth

Proposed Rule 18a-2 would require stand-alone MSBSPs to maintain positive tangible net worth.⁵³² Under proposed Rule 18a-2, tangible net worth would be defined to mean the MSBSP's net worth, as determined in accordance with GAAP in the U.S., excluding goodwill and other intangible assets.⁵³³ Part 1 of proposed Form SBS has a computation of tangible net worth section that would need to be completed by an MSBSP.⁵³⁴ In separate lines, the MSBSP would enter: (1) total ownership equity; and (2) goodwill and other intangible assets.⁵³⁵ The difference between those two line items would be entered in a third line to indicate the MSBSP's tangible net worth.⁵³⁶

Reserve Account Computation under Proposed Rule 18a-4

Proposed Rule 18a-4 would require an SBSD, among other things, to maintain a security-based swap customer reserve account at a bank separate from any other bank account of the SBSD.⁵³⁷ Further, proposed Rule 18a-4 would provide that the SBSD must at all times maintain in the security-based swap customer reserve bank account cash and/or qualified securities in amounts computed daily in accordance with a formula set forth in Exhibit A to proposed Rule

⁵³² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70256-70257.

⁵³³ See id.

⁵³⁴ See Part 1 of proposed Form SBS, Computation of Tangible Net Worth.

⁵³⁵ See Part 1 of proposed Form SBS, Computation of Tangible Net Worth, Lines 1 and 2.

⁵³⁶ See Part 1 of proposed Form SBS, Computation of Tangible Net Worth, Line 3.

⁵³⁷ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70282-70287. As noted above, broker-dealer SBSDs and broker-dealer MSBSPs would be subject to Rule 15c3-3 with respect to customers that are not security-based swap customers and, in the case of a broker-dealer SBSD, Rule 18a-4 with respect to security-based swap customers. Proposed Rule 18a-4 would provide that the SBSD must at all times maintain in the security-based swap customer reserve account cash and/or qualified securities in amounts computed daily in accordance with Exhibit A to proposed Rule 18a-4.

18a-4.⁵³⁸ The formula in Exhibit A to proposed Rule 18a-4 is modeled closely on the formula in Exhibit A to Rule 15c3-3.⁵³⁹ Consequently, the steps necessary to compute the reserve account deposit requirement under proposed Rule 18a-4 are, for the most part, the same steps necessary to compute the reserve account deposit requirement under Rule 15c3-3.

Part 1 of proposed Form SBS has a section on which a broker-dealer SBSB or stand-alone SBSB would provide a computation of the deposit requirement for the security-based swap customer reserve account.⁵⁴⁰ The section is modeled on the sections in the FOCUS Report Part II and Part II CSE on which broker-dealers provide a computation of the reserve account deposit requirement under Rule 15c3-3.⁵⁴¹ The computation section on proposed Form SBS has two line items that are not on the FOCUS Report Part II CSE or Part II section to account for two additional debit items that are part of the formula in Appendix A to proposed Rule 18a-4.⁵⁴²

Information for Possession or Control Requirements under Proposed Rule 18a-4

Proposed Rule 18a-4 would require an SBSB to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of

⁵³⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70282-70287.

⁵³⁹ See id.

⁵⁴⁰ See Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A. Part 2 of proposed Form SBS has an identical section that a bank SBSB would complete.

⁵⁴¹ Compare Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A, with FOCUS Report Part II CSE, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3, and FOCUS Report Part II, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3.

⁵⁴² See Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A, Lines 17 and 18. The line items on these lines require the entry of the amount of margin required and on deposit related to cleared and non-cleared security-based swaps. See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70282-70287.

security-based swap customers.⁵⁴³ Part 1 of proposed Form SBS has a section on which a broker-dealer SBSD or a stand-alone SBSD would enter information related to the possession or control requirements of Rule 18a-4.⁵⁴⁴ The section is modeled on the sections in the FOCUS Report Part II and Part II CSE on which broker-dealers report information related to the possession or control requirements of Rule 15c3-3.⁵⁴⁵

ii. Part 2 of Proposed Form SBS

As discussed above, the proposed reporting requirements for bank SBSDs and bank MSBSPs generally are designed to be tailored specifically to their activities as an SBSD or an MSBSP. However, in order to be able to monitor the financial condition of bank SBSDs and bank MSBSPs, the Commission is proposing a limited program of reporting certain general financial information by these registrants, which is based on the reporting requirements of the prudential regulators. Specifically, banks are required to file quarterly reports on FFIEC Form 031.⁵⁴⁶ Like the FOCUS Report, FFIEC Form 031 elicits financial and operational information

⁵⁴³ Under proposed Rule 18a-4, the term excess securities collateral would be defined to mean securities and money market instruments carried for the account of a security-based swap customer that have a market value in excess of the current exposure of the SBSD to the customer, excluding, under certain specified conditions, securities or money market instruments used to meet a margin requirement of a registered security-based swap clearing agency or of another SBSD. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70279. The term security-based swap customer would be defined to mean any person from whom or on whose behalf the SBSD has received or acquired or holds funds or other property for the account of the person with respect to a cleared or non-cleared security-based swap transaction. See id. at 70278. The definition would exclude a person to the extent that person has a claim for funds or other property which by contract, agreement or understanding, or by operation of law, is part of the capital of the SBSD or is subordinated to all claims of security-based swap customers of the SBSD. See id.

⁵⁴⁴ See Part 1 of proposed Form SBS, Information for Possession or Control Requirements under Rule 18a-4. Part 2 of proposed Form SBS has an identical section that a bank SBSD would complete.

⁵⁴⁵ Compare Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A, with FOCUS Report Part II CSE, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3, and FOCUS Report Part II, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3.

⁵⁴⁶ See 12 U.S.C. 161; 12 U.S.C. 324; 12 U.S.C. 1464; and 12 U.S.C. 1817. FFIEC Form 031 is available at http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_201303_f.pdf.

about a bank, which is entered into uniquely numbered line items. Part 2 of proposed Form SBS would require a bank SBSD or a bank MSBSP to report certain of the information reported on FFIEC Form 031.⁵⁴⁷ Specifically, Part 2 has: (1) a balance sheet section that largely mirrors Schedule RC to FFIEC Form 031; (2) a statement of regulatory capital section that is a scaled down version of Schedule RC-R to FFIEC Form 031; and (3) an income statement section that is a scaled down version of Schedule RI to FFIEC Form 031. Line items on proposed Form SBS that correspond to line items on FFIEC Form 031 would require the entry of the same type of information.⁵⁴⁸

Part 2 of proposed Form SBS also has sections for: (1) a reserve account computation under proposed Rule 18a-4; and (2) information for possession or control requirements under proposed Rule 18a-4. The sections of Part 2 are discussed below.

Balance Sheet

A bank must report detail about its assets, liabilities, and equity capital on Schedule RC to FFIEC Form 031.⁵⁴⁹ Schedule RC also has a "Memoranda" section that elicits information about the bank's external auditors and fiscal year end date.⁵⁵⁰ Bank SBSDs and bank MSBSPs would be required to report detail about their assets, liabilities, and equity capital on a balance

⁵⁴⁷ Obtaining a bank's FFIEC Form 031 information through Form SBS will allow Commission staff to easily and efficiently retrieve and transfer the information into a database where values can be compared over time and with other firms. For example, broker-dealers submit FOCUS Reports electronically to FINRA through a user-interactive portal known as "eFOCUS." This allows FINRA and Commission staff to easily and efficiently retrieve firm-specific data as well as aggregate data across firms.

⁵⁴⁸ The identifying number of each Line Item on proposed Form SBS shares the same first four characters as the corresponding Line Item on FFIEC Form 031. However, the Form SBS line items end with an additional "b" character. For example, Line Item 0081 on FFIEC Form 031 is Line Item 0081b on proposed Form SBS. The additional "b" accounts for the fact that some of the line items on FFIEC Form 031 have the same unique numbers as line items on the FOCUS Report.

⁵⁴⁹ See FFIEC Form 031, Schedule RC, Balance Sheet, Lines 1-29.

⁵⁵⁰ See FFIEC Form 031, Schedule RC, Balance Sheet, Memoranda, Lines 1-2.

sheet section on Part 2 of proposed Form SBS.⁵⁵¹ The balance sheet section would have the same line items as Schedule RC to FFIEC Form 031, except it would not include line items from the "Memoranda" section.⁵⁵² Consequently, bank SBSDs and bank MSBSPs would be required to report in proposed Form SBS the same information about assets, liabilities, and equity capital that they report in Schedule RC (excluding the Memoranda information).

Regulatory Capital

A bank must report detail about its regulatory capital on Schedule RC-R to FFIEC Form 031.⁵⁵³ Schedule RC-R also has a "Memoranda" section that elicits detail about derivatives.⁵⁵⁴ The information elicited on Schedule RC-R is designed to facilitate an analysis of the bank's regulatory capital. As discussed above in section II.A.1. of this release, the prudential regulators are responsible for administering capital requirements for bank SBSDs and bank MSBSPs.⁵⁵⁵ The prudential regulators have proposed capital rules that would require a bank SBSD or bank MSBSP to comply with the capital rules applicable to banks.⁵⁵⁶

Bank SBSDs and bank MSBSPs would be required to report detail about their regulatory capital on a section on Part 2 of proposed Form SBS.⁵⁵⁷ The regulatory capital section would include certain – but not all – of the line items on Schedule RC-R.⁵⁵⁸ The included line items

⁵⁵¹ See Part 2 of proposed Form SBS, Balance Sheet (Information As Reported On FFIEC Form 031 – Schedule RC), Lines 1–29.

⁵⁵² Compare Part 2 of proposed Form SBS, Balance Sheet (Information As Reported On FFIEC Form 031 – Schedule RC), Lines 1–29, with FFIEC Form 031, Schedule RC, Balance Sheet, Lines 1–29.

⁵⁵³ See FFIEC Form 031, Schedule RC-R, Regulatory Capital, Lines 1–62.

⁵⁵⁴ See FFIEC Form 031, Schedule RC-R, Regulatory Capital, Memoranda, Lines 1–2.

⁵⁵⁵ See 15 U.S.C. 78o-10(e)(2).

⁵⁵⁶ See Margin and Capital Requirements for Covered Swap Entities, 76 FR 27564.

⁵⁵⁷ See Part 2 of Proposed Form SBS, Regulatory Capital (Information As Reported On FFIEC Form 031 – Schedule RC-R), Lines 1–10.

⁵⁵⁸ See Line Items 3210, 8274, 5311, 1395, 3792, A223, L138, 7204, 7206, 7205, 7273, 7274, and 7275 of FFIEC Form 031 and proposed Form SBS.

require a bank to enter total amounts of the components of bank regulatory capital (e.g., total Tier 1, Tier 2, or Tier 3 capital) and other summary measures. The objective is to require high level reporting of key elements of the regulatory capital of a bank SBSD or bank MSBSP to obtain a profile of the firm's regulatory capital position. Thus, the information elicited in Part 2 of proposed Form SBS would not involve the level of detail required by the prudential regulators on Schedule RC-R.

Income Statement

A bank must report detail about its income (loss) and expenses on Schedule RI to FFIEC Form 031.⁵⁵⁹ Schedule RI also has a "Memoranda" section that elicits further detail about income (loss).⁵⁶⁰ Bank SBSDs and bank MSBSPs would be required to report detail about their income (loss) and expenses on an income section on Part 2 of proposed Form SBS.⁵⁶¹ However, the level of detail would be significantly less than is required in Schedule RI. Specifically, to focus the reporting on summary information and information relevant to securities and derivatives activities, the income section only includes line items from Schedule RI that require the entry of: (1) total amounts for categories of income, expense, and loss;⁵⁶² (2) detail about gains and losses on securities positions;⁵⁶³ (3) detail about trading revenues;⁵⁶⁴ and (4) detail about gains and losses on derivatives.⁵⁶⁵

Reserve Account Computation under Proposed Rule 18a-4

⁵⁵⁹ See FFIEC Form 031, Schedule RI, Income Statement, Lines 1-14.

⁵⁶⁰ See FFIEC Form 031, Schedule RI, Income Statement, Memoranda, Lines 1-14.

⁵⁶¹ See Part 2 of Proposed Form SBS, Income Statement (Information As Reported On FFIEC Form 031 - Schedule RI), Lines 1-11.

⁵⁶² See Line Items 4107, 4073, 4079, 4093, 4301, and 4340 of FFIEC Form 031 and proposed Form SBS.

⁵⁶³ See Line Items 3521 and 3196 of FFIEC Form 031 and proposed Form SBS.

⁵⁶⁴ See Line Items 8757, 8758, 8759, 8760, F186, K090, and K094 of FFIEC Form 031 and proposed Form SBS.

⁵⁶⁵ See Line Items C889, C890, and A251 of FFIEC Form 031 and proposed Form SBS.

As discussed above, Part 1 of proposed Form SBS has a section on which a broker-dealer SBSD or stand-alone SBSD would provide a computation of the deposit requirement for the security-based swap customer reserve account.⁵⁶⁶ This section is modeled on the sections of the FOCUS Report Part II and Part II CSE on which broker-dealers provide a computation of the customer reserve account deposit requirement under Rule 15c3-3.⁵⁶⁷ Part 2 of proposed Form SBS has an identical section that would be completed by a bank SBSD.⁵⁶⁸

Information for Possession or Control Requirements under Proposed Rule 18a-4

As discussed above, Part 1 of proposed Form SBS has a section on which a broker-dealer SBSD or a stand-alone SBSD would enter information related to the possession or control requirements of Rule 18a-4.⁵⁶⁹ The section is modeled on the sections of the FOCUS Report Part II and Part II CSE on which broker-dealers provide information related to the possession or control requirements of Rule 15c3-3.⁵⁷⁰ Part 2 of proposed Form SBS has an identical section that would be completed by a bank SBSD.⁵⁷¹

⁵⁶⁶ See Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A.

⁵⁶⁷ Compare Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A, with the FOCUS Report Part II CSE, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3 and the FOCUS Report Part II, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3.

⁵⁶⁸ See Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A.

⁵⁶⁹ See Part 1 of proposed Form SBS, Information for Possession or Control Requirements under Rule 18a-4.

⁵⁷⁰ Compare Part 1 of proposed Form SBS, Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Exhibit A, with the FOCUS Report Part II CSE, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3 and the FOCUS Report Part II, Computation for the Determination of Reserve Requirements for Broker-Dealers under Rule 15c3-3.

⁵⁷¹ See Part 2 of proposed Form SBS, Information for Possession or Control Requirements under Rule 18a-4.

iii. Part 3 of Proposed Form SBS

FCMs are required to periodically file with the CFTC and their designated SRO Form 1-FR-FCM.⁵⁷² Like the FOCUS Report and FFIEC Form 031, Form 1-FR-FCM elicits financial and operational information about an FCM, which is entered into uniquely numbered line items. To account for ANC broker-dealers that are dually registered as FCMs, the FOCUS Report Part II CSE incorporates, substantially in the same format, the following from Form 1-FR FCM:⁵⁷³ (1) a section to show a statement of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges;⁵⁷⁴ (2) a section to show a statement of segregation requirements and funds in segregation for customers' dealer options account;⁵⁷⁵ (3) a section to show a summary statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers pursuant to CFTC Regulation 30.7;⁵⁷⁶ (4) a section

⁵⁷² See 17 CFR 1.10. See also Form 1-FR-FCM, available at <http://www.nfa.futures.org/NFA-registration/templates-and-forms/form1FR-fcm.HTML>.

⁵⁷³ The FOCUS Report Part II CSE assigns different numbers to the line items.

⁵⁷⁴ See FOCUS Report Part II CSE, Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges, Lines 1–14. Section 4d of the CEA requires each FCM to segregate from its own assets all money, securities and other property deposited by futures customers to margin, secure, or guarantee futures contracts and options on futures contracts traded on designated contract markets. It further requires an FCM to treat and deal with futures customer funds as belonging to the futures customer, and prohibits an FCM from using the funds deposited by the futures customer to margin or extend credit to any person other than the futures customer that deposited the funds. 7 U.S.C. 6d. The CFTC has adopted Rules 1.20 through 1.30 to implement section 4d. See 17 CFR 1.20 through 1.30. The Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges generally indicates the total amount of funds held by the FCM in segregated accounts, the total amount of funds that the FCM must hold in segregated accounts to meet its regulatory obligations to futures customers, and whether the firm holds excess segregated funds in the segregated accounts as of the reporting date.

⁵⁷⁵ See FOCUS Report Part II CSE, Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts, Lines 1–3. Rule 1.32 requires an FCM to prepare a daily computation which shows: (1) the amount of funds that an FCM is required to segregate for customers who are trading on U.S. commodity exchanges pursuant to the CEA and CFTC rules; (2) the amount of funds the FCM actually has in segregated accounts; and (3) the amount, if any, of the FCM's residual interest in the customer funds segregated. See 17 CFR 1.32.

⁵⁷⁶ See FOCUS Report Part II CSE, Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7, Foreign Futures and Foreign Options Secured Amount: Summary, Lines I–II, 1–3. Section 4(b) of the CEA provides that the CFTC may adopt rules and regulations proscribing fraud and requiring minimum financial standards,

to show a statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers pursuant to CFTC Regulation 30.7;⁵⁷⁷ and (5) a section to show a computation of the firm's minimum capital requirement.⁵⁷⁸ An ANC broker-dealer dually registered as an FCM can file the FOCUS Report Part II CSE rather than Form 1-FR-FCM.⁵⁷⁹

The CFTC recently adopted amendments to Form 1-FR-FCM that change the format of the sections identified in items (1), (3), and (4) above to enhance customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosures, and auditing and examination programs for FCMs.⁵⁸⁰ The format of these

the disclosure of risk, the filing of reports, the keeping of books and records, the safeguarding of the funds deposited by persons for trading on foreign markets, and registration with the CFTC by any person located in the U.S. who engages in the offer or sale of any contract of sale of a commodity for future delivery that is made subject to the rules of a board of trade located outside of the U.S. See 7 U.S.C. 6. Pursuant to section 4(b), the CFTC adopted Part 30 of its regulations to address foreign futures and foreign option transactions. See 17 CFR 30.1 through 30.13. Rule 30.7 provides that an FCM may deposit the funds belonging to foreign futures or foreign options customer in an account or accounts maintained at a bank or trust company located in the U.S., a bank or trust company located outside the U.S. that has in excess of \$1 billion of regulatory capital, an FCM registered with the CFTC, a derivatives clearing organization, a member of a foreign board of trade, a foreign clearing organization, or a depository selected by the member of a foreign board of trade or foreign clearing organization. See 17 CFR 30.7.

⁵⁷⁷ See FOCUS Report Part II CSE, Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7, Funds Deposited In Separate 17 C.F.R. § 30.7 Accounts, Lines 1–8. This statement generally indicates the total amount of funds held by the FCM in secured accounts, the total amount of funds that the FCM must hold in secured accounts to meet its regulatory obligations to foreign futures or foreign options customers, and whether the firm holds excess secured funds in the secured accounts as of the reporting date.

⁵⁷⁸ See FOCUS Report Part II CSE, Computation of CFTC Minimum Net Capital Requirement, Lines A–C. A broker-dealer dually registered as an FCM is required to maintain net capital in an amount at least equal to the greater of: (1) the minimum amount required of a broker-dealer under Rule 15c3-1; and (2) the minimum amount required of an FCM under CFTC Rule 1.17. See 17 CFR 1.17; 17 CFR 240.15c3-1.

⁵⁷⁹ See 17 CFR 1.10(h) (allowing broker-dealers to file the FOCUS Report instead of Form 1-FR-FCM so long as all information required to be furnished on and submitted with Form 1-FR-FCM is provided with the FOCUS Report). See also instructions to Form 1-FR-FCM, available at <http://www.cftc.gov/ucm/groups/public/@jintermediaries/documents/file/1fr-fcminstructions.pdf>; Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR 68506, 68513 (Nov. 14, 2013).

⁵⁸⁰ See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR at 68512.

sections in proposed Form SBS are substantively the same as the format of these recently amended sections of Form 1-FR-FCM.⁵⁸¹

In addition, the CFTC adopted a new section for Form 1-FR-FCM that requires an FCM to provide detail about segregation requirements and funds in cleared swap customer accounts.⁵⁸² This new section is comparable to the section on which an FCM provides a Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges.⁵⁸³ The purpose of the new section is to provide an FCM that carries accounts for customers that maintain cleared swap positions with a means to document and to demonstrate its compliance with its obligation to treat, and deal with all money, securities, and property of any swap customer received to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization (including money, securities, or property accruing to swap customers as the result of such a swap) as belonging to the FCM's swap customers as required by section 4d of the CEA.⁵⁸⁴

Consistent with the CFTC's recent amendment, proposed Form SBS would include a section requiring an FCM filer to report detail about segregation requirements and funds in

⁵⁸¹ One of the objectives of including the Form 1-FR-FCM sections in proposed Form SBS is to permit a filer that is dually registered as an FCM to be able to use proposed Form SBS to comply with reporting requirements of the CFTC, subject to approval by the CFTC. This objective could be defeated if the format of the sections on proposed Form SBS is substantively different than the format of the sections on Form 1-FR-FCM. See 17 CFR 1.10(h) (allowing broker-dealers to file the FOCUS Report instead of Form 1-FR-FCM so long as all information required to be furnished on and submitted with Form 1-FR-FCM is provided with the FOCUS Report).

⁵⁸² See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR at 68514.

⁵⁸³ See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR at 68513.

⁵⁸⁴ See id. at 68507. See also 7 U.S.C. 6d.

cleared swap customer accounts.⁵⁸⁵ The format of the section mirrors the format of the section adopted by the CFTC to be included on Form 1-FR-FCM.

iv. Part 4 of Proposed Form SBS

Part 4 of proposed Form SBS would apply to nonbank SBSDs and nonbank MSBSPs. Part 4 consists of four schedules that elicit detailed information about a firm's security-based swap and swap positions, counterparties, and exposures. As discussed below, certain of the schedules are modeled on schedules to the FOCUS Report.

The schedules in Part 4 of proposed Form SBS would require filers to report information relating to their exposures resulting from over-the-counter derivatives exposures (including exposures relating to security-based swaps and swaps). The instructions to proposed Form SBS would define terms that are used to indicate the type of information to be entered about the exposures. Specifically, the terms are: (1) gross replacement value also referred to as gross replacement value – receivable;⁵⁸⁶ (2) gross replacement value – payable;⁵⁸⁷ (3) net replacement

⁵⁸⁵ See Part 3 of proposed Form SBS, Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4D(F) of the Commodity Exchange Act, Lines 1–16.

⁵⁸⁶ The instructions to proposed Form SBS would define the terms gross replacement value and gross replacement value – receivable as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a positive mark-to-market value to the firm (i.e., are receivable positions of the firm), without applying any netting or collateral. See the Definitions section of the instructions to proposed Form SBS. Applicable netting and collateral rules would include Appendix E to Rule 15c3-1 that prescribes, and proposed Rule 18a-1 that would prescribe, requirements for when netting agreements and collateral can be taken into account for purposes of calculating credit risk charges as part of computing net capital. See 17 CFR 240.15c3-1e(c)(4)(iv) and (v); Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70240–70245. In addition, proposed Rule 18a-3 would prescribe when netting agreements and collateral can be taken into account for purposes calculating margin requirements for non-cleared security-based swaps. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70260–70265. The CFTC also has requirements for netting agreements and collateral for the purposes of the proposed capital requirements for swap dealers and major swap participants. See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR 68506. Similarly, the prudential regulators have proposed requirements for netting agreements and collateral for the purposes of their proposed capital and margin requirements for bank SBSDs, bank MSBSPs, bank swap dealers, and bank major swap participants. See Margin and Capital Requirements for Covered Swap Entities, 76 FR 27564.

value;⁵⁸⁸ (4) current net exposure;⁵⁸⁹ (5) total exposure;⁵⁹⁰ and (6) margin collected.⁵⁹¹

Schedule 1

ANC broker-dealers are required to complete a schedule on the FOCUS Report Part II CSE to report the dollar amount of the aggregate long and short positions in various categories of financial instruments held by the firm.⁵⁹² The categories include, for example, U.S. treasury securities, foreign debt securities, foreign equity securities, and corporate obligations. The schedule has a single line for derivatives.⁵⁹³ Schedule 1 to Part 4 of proposed Form SBS has a subsection that elicits the dollar amount of the aggregate long and short positions in the same categories of non-derivative financial instruments as the FOCUS Report Part II CSE section.⁵⁹⁴

⁵⁸⁷ The instructions to proposed Form SBS would define the term gross replacement value – payable as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a negative mark-to-market value to the firm (i.e., are payable positions of the firm), without applying any netting or collateral. See the Definitions section of the instructions to proposed Form SBS.

⁵⁸⁸ The instructions to proposed Form SBS would define the term net replacement value as the amount of the “gross replacement value – receivable” minus the amount of the “gross replacement value – payable” that may be netted for each counterparty in accordance with applicable rules. See the Definitions section of the instructions to proposed Form SBS.

⁵⁸⁹ The instructions to proposed Form SBS would define the term current net exposure as the net replacement value minus the fair market value of collateral collected that may be applied under applicable rules (e.g., taking into account haircuts to the fair market value of the collateral required under applicable rules). See the Definitions section of the instructions to proposed Form SBS.

⁵⁹⁰ The instructions to proposed Form SBS would define the term total exposure as the sum of the following (as applicable): (1) the current net exposure; (2) the amount of initial margin for cleared security-based swaps and swaps required by a clearing agency or derivatives clearing organization (regardless of whether the margin has been collected); (3) the margin amount for uncleared security-based swaps calculated under paragraph (c) of proposed Rule 18a-3; (4) the initial margin for non-cleared swaps calculated under the CFTC’s rules (regardless of whether the margin has been collected); and (5) maximum potential exposure as defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable, for any over-the-counter derivatives not included above. See the Definitions section of the instructions to proposed Form SBS.

⁵⁹¹ The instructions to proposed Form SBS would define the term margin collected as the amount of initial margin collateral collected that can be applied against the firm’s total exposure under applicable rules. See the Definitions section of the instructions to proposed Form SBS.

⁵⁹² See FOCUS Report Part II CSE, Aggregate Securities and OTC Derivatives Positions, Lines 1–15. OTC derivatives dealers are required to provide similar information in a section on the FOCUS Report Part IIB. See FOCUS Report Part IIB, Schedule VI, Aggregate Securities and Commodities Positions, Lines 1–15.

⁵⁹³ See FOCUS Report Part II CSE, Aggregate Securities and OTC Derivatives Positions, Line 11.

⁵⁹⁴ See Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Lines 1–18.

Schedule 1 elicits more detail about security-based swap, mixed swap, and swap positions than the parallel FOCUS Report Part II CSE section.⁵⁹⁵ Specifically, it would require the filer to enter the aggregate long and short positions for cleared and non-cleared: (1) debt security-based swaps (other than credit default swaps); (2) equity security-based swaps, (3) credit default security-based swaps; and (4) other security-based swaps.⁵⁹⁶ It further would require the same information with respect to mixed swaps⁵⁹⁷ and the following categories of swaps: (1) interest rate swaps; (2) foreign exchange swaps; (3) commodity swaps; (4) debt index swaps (other than credit default swaps); (5) equity index swaps; (6) credit default swaps; and (7) other swaps.⁵⁹⁸ The instructions to proposed Form SBS would direct firms to report the month-end gross replacement value for cleared and non-cleared receivables in the long column, and report the month-end gross replacement value for cleared and non-cleared receivables in the short column.⁵⁹⁹

⁵⁹⁵ In addition to the differences discussed below, for increased clarity, Line 2 of the proposed Form SBS schedule would read "U.S. government agency and U.S. government-sponsored enterprises" instead of "U.S. government agency and government-sponsored entities". Compare FOCUS Report Part II CSE, Aggregate Securities and OTC Derivatives Positions, Line 2 with Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Line 2. Moreover, the proposed Form SBS schedule would elicit detail with respect to two categories of U.S. government agency securities and U.S. government sponsored enterprise securities: debt securities and mortgage-backed securities. Finally, for increased clarity, Line 17 would read "Securities with no ready market" instead of "Investments with no ready market". Compare FOCUS Report Part II CSE, Aggregate Securities and OTC Derivatives Positions, Line 13 with Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Line 17. See also Letter from Howard Spindel, Senior Managing Director, and Cassandra E. Joseph, Managing Director, Integrated Management Solutions USA LLC to FINRA (Feb. 25, 2013), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticerecommendations/p213401.pdf> (suggesting such a modification).

⁵⁹⁶ See Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Lines 12A–12D.

⁵⁹⁷ See Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Line 13.

⁵⁹⁸ See Part 4 of proposed Form SBS, Schedule 1, Aggregate Securities, Commodities, and Swaps Positions, Lines 14A–14G.

⁵⁹⁹ See instructions to proposed Form SBS for Part 4, Schedule 1.

Schedule 2

ANC broker-dealers are required to provide detail on Schedule III to the FOCUS Report Part II CSE about the fifteen counterparties to which they have the largest credit exposures in derivatives.⁶⁰⁰ The FOCUS Report Part II CSE specifies that an ANC broker-dealer must provide for each of the fifteen counterparties: (1) a counterparty identifier; (2) the counterparty's country; (3) the counterparty's industry segment; (4) the counterparty's credit rating; (5) the gross replacement value of the receivables from and payables to the counterparty; (6) the net replacement value of the transactions with the counterparty; (7) the current net exposure to the counterparty; (8) the total credit exposure to the counterparty; and (9) the aggregate maximum potential exposure to the counterparty.⁶⁰¹ It also requires total amounts for items (5) through (9) above (*i.e.*, the sum of the amounts for the fifteen counterparties).⁶⁰²

Schedule 2 to Part 4 of proposed Form SBS has two tables that are modeled on Schedule III to the FOCUS Report Part II CSE.⁶⁰³ The first table would require a nonbank SBSD or a nonbank MSBSP to identify in the first column the fifteen counterparties to which the firm has the largest current net exposure in the order from the largest to the smallest current net exposure.⁶⁰⁴ The second table would require the filer to identify in the first column the fifteen counterparties to which the firm as the largest total exposure in the order from the largest to the

⁶⁰⁰ See FOCUS Report Part II CSE, Schedule III, Credit-Concentration Report for Fifteen Largest Net Exposures in Derivatives. OTC derivatives dealers are required to provide similar information in a section on the FOCUS Report Part IIB. See FOCUS Report Part IIB, Schedule I, Credit-Concentration Report for Twenty Largest Current Net Exposures.

⁶⁰¹ See FOCUS Report Part II CSE, Schedule III, Credit-Concentration Report for Fifteen Largest Net Exposures in Derivatives.

⁶⁰² See FOCUS Report Part II CSE Line Items 7810, 7811, 7812, 7813, 7814, and 7815.

⁶⁰³ Compare Part 4 of proposed Form SBS, Schedule 2, Credit Concentration Report for Fifteen Largest Exposures in Derivatives, with FOCUS Report Part II CSE, Schedule III, Credit-Concentration Report for Fifteen Largest Net Exposures in Derivatives.

⁶⁰⁴ See Part 4 of proposed Form SBS, Schedule 2, Credit Concentration Report for Fifteen Largest Exposures in Derivatives, Table I.

smallest total exposure.⁶⁰⁵ For each counterparty, the filer would need to enter into the tables the following information: (1) the counterparty's unique identifier; (2) the counterparty's internal credit rating assigned by the SBS or MSBS; (3) the amount of the gross replacement value – receivables from the counterparty (gross gain); (4) the amount of the gross replacement value – payables to the counterparty (gross gain); (5) the amount of the net replacement value of the derivatives positions with the counterparty; (6) the current net exposure to the counterparty; (7) the total exposure to the counterparty; and (8) the margin collected from the counterparty.⁶⁰⁶ For items (3) through (8) above, the filer also would be required to provide the aggregate amounts for all counterparties other than the fifteen specifically reported counterparties.

Schedule 3

ANC broker-dealers are required to provide detail on a table on Schedule IV to the FOCUS Report Part II CSE about their aggregate credit exposures to counterparties grouped by the internal credit rating assigned by the ANC broker-dealer to the counterparty.⁶⁰⁷ Specifically, for each notch in the ANC broker-dealer's rating scale, the firm must provide the following information aggregated across all counterparties rated at that notch: (1) the current net exposure to the counterparties; (2) the net replacement value of the transactions with the counterparties; (3) the gross replacement value of the receivables from and payables to the counterparties; and (4) the aggregate maximum potential exposure to the counterparties.⁶⁰⁸ It also requires total

⁶⁰⁵ See Part 4 of proposed Form SBS, Schedule 2, Credit Concentration Report for Fifteen Largest Exposures in Derivatives, Table II.

⁶⁰⁶ See Part 4 of proposed Form SBS, Schedule 2, Credit Concentration Report for Fifteen Largest Exposures in Derivatives, Tables I and II. The Commission is proposing to add a line item to elicit the amount of margin collected from the counterparty in order to provide a means to monitor how much of the exposure to the counterparty is collateralized thereby mitigating the risk to the firm of the counterparty's default.

⁶⁰⁷ See FOCUS Report Part II CSE, Schedule IV, Portfolio Summary of OTC Derivatives Exposures by Internal Credit Rating.

⁶⁰⁸ See *id.*

amounts for these items.⁶⁰⁹

Schedule 3 to Part 4 of proposed Form SBS has a table that is modeled on Schedule IV to the FOCUS Report Part II CSE.⁶¹⁰ This table would require the filer to set forth its internal credit rating scale in the left hand column.⁶¹¹ For each notch in the rating scale, the filer would need to provide: (1) the amount of the gross replacement value – receivables from the counterparties rated at that notch; (2) the amount of the gross replacement value – payables to the counterparties rated at that notch; (3) the amount of the net replacement value of the derivatives positions with the counterparties rated at that notch; (4) the current net exposure to the counterparties rated at that notch; (5) the total exposure to the counterparties rated at that notch; and (6) the margin collected from the counterparties rated at that notch.⁶¹²

Schedule 4

ANC broker-dealers are required to provide detail on a table on Schedule II to the FOCUS Report Part II CSE about their OTC derivatives exposures grouped by country.⁶¹³ Specifically, for each country, the firm must provide the following information aggregated across all counterparties located in that country and grouped by credit rating category: (1) the current net exposure to the counterparties; (2) the net replacement value of the transactions with the

⁶⁰⁹ See FOCUS Report Part II CSE Line Items 7820, 7821, 7822, 7823, and 7824.

⁶¹⁰ See Part 4 of proposed Form SBS, Schedule 3, Portfolio Summary of OTC Derivatives Exposures by Internal Credit Rating.

⁶¹¹ The instructions to proposed Form SBS would provide that each category and notches within a category would constitute a “notch” in the rating scale. For example, the following symbols would each represent a notch in the rating scale in descending order: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, CCC+, CCC, CCC-, CC, C, and D.

⁶¹² See Part 4 of proposed Form SBS, Schedule 3, Portfolio Summary of OTC Derivatives Exposures by Internal Credit Rating. As noted above, the line item added to the schedule to elicit the amount of margin collected from the counterparties is intended to have a means to monitor how much of the exposure to the counterparties is collateralized thereby mitigating the risk to the firm of a counterparty’s default.

⁶¹³ See FOCUS Report Part II CSE, Schedule II, Geographic Distribution of OTC Derivatives Exposures for Ten Largest Countries. OTC derivatives dealers are required to provide similar information in a section on the FOCUS Report Part IIB. See FOCUS Report Part IIB, Schedule III, Geographic Distribution of OTC Derivatives Exposures.

counterparties; and (3) the gross replacement value of the receivables from and payables to the counterparties.⁶¹⁴ It also requires total amounts for these items.⁶¹⁵

Schedule 4 to Part 4 of proposed Form SBS has two tables that are modeled on Schedule II to the FOCUS Report Part II CSE.⁶¹⁶ The first table would require the filer to identify in the left column the ten largest countries in terms of the filer's aggregate current net exposure to counterparties located in the country in the order from the largest to the smallest current net exposure amounts.⁶¹⁷ The second table would require the filer to identify in the left column the ten largest countries in terms of the filer's aggregate total exposure to counterparties located in the country in the order from the largest to the smallest total exposure amounts.⁶¹⁸ For each country, the filer would need to enter into the tables the following information: (1) the amount of the gross replacement value – receivables from the counterparties located in the country; (2) the amount of the gross replacement value – payables to counterparties located in the country; (3) the amount of the net replacement value of the derivatives positions with the counterparties located in the country; (4) the current net exposure to counterparties located in the country; (5) the total exposure to counterparties located in the country; and (6) the amount of margin collected from counterparties located in the country.⁶¹⁹

⁶¹⁴ See *id.*

⁶¹⁵ See FOCUS Report Part II CSE Line Items 7901, 7902, 7903, and 7904.

⁶¹⁶ See Part 4 of proposed Form SBS, Schedule 4, Geographic Distribution of OTC Derivatives Exposures for Ten Largest Countries.

⁶¹⁷ See Part 4 of proposed Form SBS, Schedule 4, Geographic Distribution of OTC Derivatives Exposures for Ten Largest Countries, Table I.

⁶¹⁸ See Part 4 of proposed Form SBS, Schedule 4, Geographic Distribution of OTC Derivatives Exposures for Ten Largest Countries, Table II.

⁶¹⁹ See Part 4 of proposed Form SBS, Schedule 4, Geographic Distribution of OTC Derivatives Exposures for Ten Largest Countries, Tables I and II. Requiring nonbank SBSs and nonbank MSBSPs to report their derivatives exposures by country allows Commission staff to monitor firms with concentrated exposures to a particular country, which can present risk if a localized event occurs (e.g., a sovereign downgrade). As noted above, the line item added to the schedule to elicit the amount of margin collected from the

v. Part 5 of Proposed Form SBS

Part 5 of proposed Form SBS would apply to bank SBSDs and bank MSBSPs. Part 5 consists of one schedule that is a truncated version of Schedule 1 to Part 4 of proposed Form SBS.⁶²⁰ Specifically, Schedule 1 to Part 5 only would elicit detail about the filer's security-based swap, mixed-swap, and swap positions. In particular, Schedule 1 to Part 5 would require the filer to report the aggregate long and short positions for the following categories of cleared and non-cleared security-based swaps: (1) debt security-based swaps (other than credit default swaps); (2) equity security-based swaps; (3) credit default security-based swaps; and (4) other security-based swaps.⁶²¹ It further would require the same information with respect to mixed swaps⁶²² and the following categories of swaps: (1) interest rate swaps; (2) foreign exchange swaps; (3) commodity swaps; (4) debt index swaps (other than credit default swaps); (5) equity index swaps; (6) credit default swaps; and (7) other swaps.⁶²³

Request for Comment

The Commission generally requests comment on proposed Form SBS. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. As proposed, a broker-dealer that is not dually registered as an SBSD or MSBSP would continue to file Part IIA, Part IIB, or Part II CSE of the FOCUS Report, as applicable,

counterparties is intended to provide a means to monitor how much of the exposure to the counterparties is collateralized thereby mitigating the risk to the firm of a counterparty's default.

⁶²⁰ See Part 5 of proposed Form SBS, Schedule 1, Aggregate Security-Based Swap and Swaps Positions.

⁶²¹ See Part 5 of proposed Form SBS, Schedule 1, Aggregate Security-Based Swap and Swaps Positions, Lines 1A-1D.

⁶²² See Part 5 of proposed Form SBS, Schedule 1, Aggregate Security-Based Swap and Swaps Positions, Line 2.

⁶²³ See Part 5 of proposed Form SBS, Schedule 1, Aggregate Security-Based Swap and Swaps Positions, Lines 3A-3G.

whereas SBSDs and MSBSPs (including broker-dealer SBSDs and broker-dealer MSBSPs) would file Form SBS. As an alternative, all broker-dealers, SBSDs, and MSBSPs could be required to file the same consolidated form – Form SBS, which could be re-titled the “FOCUS Report Part II” or some similar name. Under this alternative, broker-dealers not dually registered as an SBSD or MSBSP (“stand-alone broker-dealers”) would complete Parts 1 and 4 of Form SBS (and would also complete Part 3 if they are dually registered as an FCM). Should all broker-dealers, SBSDs, and MSBSPs file the same consolidated form? Explain why or why not, and quantify any estimated burdens associated with this alternative.

2. Does proposed Form SBS elicit the appropriate information for the various types of registrants that would be required to complete and file the form (e.g., stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, bank MSBSPs, broker-dealer SBSDs, and broker-dealer MSPSPs)? If not, how should proposed Form SBS be modified to address the information elicited from particular registrant(s)?
3. If stand-alone SBSDs and stand-alone MSBSPs are required to file Form SBS with the Commission (instead of with the Commission’s designee), should the Commission require these firms to file Form SBS electronically? Explain why or why not. If Form SBS should be filed electronically, should it be filed using the Commission’s EDGAR system, as an Excel spreadsheet, as a delimiter separated value (DSV) file, and/or using some other electronic format?
4. Are there any line items in proposed Form SBS that require further clarification or instruction? If so, identify the applicable line items and explain the needed clarification or instruction.

5. Proposed Form SBS consists of five parts. An SBSD or MSBSP would need to complete: (1) Parts 1 and 4 of Form SBS if it is a stand-alone SBSD, broker-dealer SBSD, stand-alone MSBSP, or broker-dealer MSBSP; or (2) Parts 2 and 5 of Form SBS if it is a bank SBSD or bank MSBSP. Should Parts 1 and 4 be consolidated into a single part? Should Parts 2 and 5 be consolidated into a single part? Explain why or why not.
6. Proposed Form SBS would include line items that are not on the FOCUS Report or CFTC Form 1-FR-FCM. Is it inappropriate to include any of these new line items on Form SBS? If so, identify the line item and explain why it would not be appropriate to include it. Should any new line items that are not currently included in proposed Form SBS be added? If so, describe the new line item and where it should be included on the form, provide accompanying instructions, and explain why it should be included.
7. Are there any line items that should not be included on proposed Form SBS because they are no longer relevant to broker-dealer activities or would not be relevant to SBSD or MSBSP activities? For example, are Line Items 150, 160, and 190 relevant to broker-dealer activities? Similarly, is Note B to the Financial and Operational Data section widely used? Explain why or why not. If a line item is not relevant to broker-dealer activities, should the Commission remove it from the FOCUS Report? Explain why or why not.
8. Should the Commission rely on the public call reports completed by bank SBSDs and bank MSBSPs to gather the information necessary to monitor the transactions, positions and financial condition of the bank SBSDs and bank MSBSPs, instead of requiring such firms to complete and file with the Commission Parts 2 and 5 of Form SBS? If so, explain why.

9. The instructions for proposed Form SBS define "total exposure" as the sum of several amounts, including "[t]he amount of initial margin for cleared security-based swaps and swaps required by a clearing agency or derivatives clearing organization (regardless of whether the margin has been collected)." Should the definition of "total exposure" instead include the capital charge that would apply to the positions under Rule 15c3-1 or proposed Rule 18a-1, as applicable? Explain why or why not.
10. According to the proposed instructions for proposed Form SBS, firms should report on Line Item 120 the market value of encumbered securities that the firm transferred to a creditor and that the creditor has the right to sell or re-pledge. Should this instruction instead direct firms to report any encumbered security, whether or not the creditor has the right to sell or re-pledge the collateral? If this instruction should be changed, should the instructions for the FOCUS Report relating to the corresponding line item also be changed? Explain why or why not.
11. With respect to Line Items 190, 650, 660, and 900 of proposed Form SBS, do broker-dealers continue to own exchange memberships as assets? If so, are their values, relative to the rest of a broker-dealer's assets, significant enough to continue collecting this information as a separate line item? Explain why or why not.
12. Should broker-dealer MSBSPs be required to complete the section entitled "Computation of Tangible Net Worth" in addition to the sections relating to the computation of net capital and minimum net capital requirement? Explain why or why not.
13. Schedule 1 of Part 4 and Schedule 1 of Part 5 of proposed Form SBS request information about four categories of security-based swaps: (1) debt security-based swaps, (2) equity security-based swaps, (3) credit default security-based swaps, and (4) other security-

based swaps. These schedules also request information about seven categories of swaps: (1) interest rate swaps, (2) foreign exchange swaps, (3) commodity swaps, (4) debt index swaps, (5) equity index swaps, (6) credit default swaps, and (7) other swaps. Should different categories of security-based swaps and swaps be specified for purposes of the Form? Explain why or why not. If different categories should be specified, identify and define the alternative categories, and explain why these alternative categories should be specified.

14. Are there terms used in proposed Form SBS and/or its instructions that are not defined that should be defined? If so, identify the term and describe how it should be defined. For example, should the following terms in Schedule 1 of Part 4 and Schedule 1 of Part 5 of proposed Form SBS be defined: (1) debt security-based swap; (2) equity security-based swap; (3) credit default security-based swap; (4) interest rate swap; (5) foreign exchange swap; (6) commodity swap; (7) debt index swap; (8) equity index swap; and/or (9) credit default swap? If so, how should these terms be defined?
15. Are there reporting requirements currently not included in these proposed rules that should be applied to ANC broker-dealer SBSs? If so, please describe them.
16. Are there additional requirements to promote the reporting of composite security-based swap transactions into disaggregated data based on risk? If so, please describe them.

3. Filing of Annual Audited Financial Reports and Other Reports

Rule 17a-5 generally requires a broker-dealer to, among other things, annually file reports audited by a PCAOB-registered independent public accountant, disclose certain financial information to customers, and notify the Commission of a change of accountant.⁶²⁴ The rule also

⁶²⁴

See 17 CFR 240.17a-5.

requires the independent public accountant to notify the broker-dealer if the accountant discovers an instance of non-compliance with certain broker-dealer rules or an instance of material weakness. As discussed above, the Commission is proposing to amend Rule 17a-5 to account for broker-dealers that are dually registered as SBSDs or MSBSPs. The Commission also is proposing certain largely technical amendments to Rule 17a-5. With respect to stand-alone SBSDs and stand-alone MSBSPs, the Commission is proposing to include in new Rule 18a-7 many requirements that would parallel requirements in Rule 17a-5, as proposed to be amended. However, proposed Rule 18a-7 does not include a parallel requirement for every requirement in Rule 17a-5.⁶²⁵ Further, the requirements in proposed Rule 18a-7, other than the requirement discussed above in section II.B.2. of this release to periodically file proposed Form SBS, would not apply to bank SBSDs and bank MSBSPs.

a. Amendments to Rule 17a-5 and Proposed Rule 18a-7

Additional ANC Broker-Dealer Reports

Paragraph (a)(6) of Rule 17a-5 requires ANC broker-dealers to periodically file certain reports with the Commission.⁶²⁶ The reports contain information related to the ANC broker-dealer's use of internal models to calculate market and credit risk charges when computing net

⁶²⁵ The Commission is not proposing to include in proposed Rule 18a-7 a requirement that is parallel to the Exemption Report requirement in paragraph (d)(4) of Rule 17a-5, as proposed to be amended, because all SBSDs would be subject to the segregation requirements in proposed Rule 18a-4. Proposed Rule 18a-7 also would not include requirements that parallel the requirements in paragraphs (d)(6) and (e)(4) of Rule 17a-5, as proposed to be amended, requiring broker-dealers to file certain reports with the Securities Investor Protection Corporation ("SIPC") because stand-alone SBSDs and stand-alone MSBSPs would not be members of SIPC. In addition, proposed Rule 18a-7 would not include a requirement that parallels the requirement for a broker-dealer to file Form Custody with the firm's DEA. Additional differences between proposed Rule 18-7 and Rule 17a-5, as proposed to be amended, are discussed below.

⁶²⁶ See 17 CFR 240.17a-5(a)(6).

capital.⁶²⁷ Specifically, ANC broker-dealers must file on either a monthly or quarterly basis the following reports:

- For each product for which the broker-dealer calculates a deduction for market risk other than in accordance with paragraphs (b)(1) or (b)(3) of Appendix E of Rule 15c3-1, the product category and the amount of the deduction for market risk (monthly report);
- A graph reflecting, for each business line, the daily intra-month VaR (monthly report);
- The aggregate VaR for the broker-dealer (monthly report);
- For each product for which the broker-dealer uses scenario analysis, the product category and the deduction for market risk (monthly report);
- Credit risk information on derivatives exposures, including: (1) overall current exposure; (2) current exposure (including commitments) listed by counterparty for the 15 largest exposures; (3) the 10 largest commitments listed by counterparty; (4) the broker-dealer's maximum potential exposure listed by counterparty for the fifteen largest exposures; (5) the broker-dealer's aggregate maximum potential exposure; (6) a summary report reflecting the broker-dealer's current and maximum potential exposures by credit rating category; and (7) a summary report reflecting the broker-dealer's current exposure for each of the top ten countries to which the broker-dealer is exposed (by residence of the main operating group of the counterparty) (monthly report);
- Regular risk reports supplied to the broker-dealer's senior management in the format described in the application (monthly report);
- A report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR (quarterly report); and
- The results of backtesting of all internal models used to compute allowable capital, including VaR and credit risk models, indicating the number of backtesting exceptions (quarterly report).⁶²⁸

The Commission uses these reports to monitor the financial condition, internal risk management control system, and activities of an ANC broker-dealer.⁶²⁹

⁶²⁷ See *id.*

⁶²⁸ See *id.*

⁶²⁹ Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities, 69 FR at 34449.

As discussed above in section II.A.2.a. of this release, the Commission has proposed amendments to Rule 15c3-1 that would establish liquidity stress test requirements for ANC broker-dealers, which would include ANC broker-dealer SBSDs.⁶³⁰ Further, the Commission has proposed identical liquidity stress test requirements for stand-alone ANC SBSDs as part of the capital requirements for SBSDs.⁶³¹ Under the proposed liquidity stress test requirements, ANC broker-dealers and stand-alone ANC SBSDs would be required, among other things, to conduct a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days.⁶³² The Commission is proposing to amend Rule 17a-5 to add a requirement that an ANC broker-dealer must file a monthly report with the Commission containing the results of the liquidity stress test.⁶³³

The Commission also proposes to include a parallel reporting requirement in proposed Rule 18a-7 applicable to stand-alone ANC SBSDs that is modeled on the reporting requirement in Rule 17a-5, as proposed to be amended, applicable to ANC broker-dealers.⁶³⁴ Consequently, stand-alone ANC SBSDs would be required to file the same types of reports relating to their use of internal models and liquidity stress tests as ANC broker-dealers, including ANC broker-dealer SBSDs.

Termination of Membership in an SRO

Paragraph (b) of Rule 17a-5 requires a broker-dealer to file with the Commission the FOCUS Report Part II or Part IIA, as applicable, within two business days after terminating its

⁶³⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252–70254.

⁶³¹ See id.

⁶³² See id.

⁶³³ See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

⁶³⁴ Compare paragraph (a)(5) of Rule 17a-5, as proposed to be amended, with paragraph (a)(3) of proposed Rule 18a-7.

membership with a national securities exchange or national securities association.⁶³⁵ The Commission is proposing to amend paragraph (b) of Rule 17a-5 to provide that in either of these events the broker-dealer must file Part II, Part IIA or proposed Form SBS.⁶³⁶ This change is designed to account for broker-dealer SBSDs and broker-dealer MSBSPs, which, as discussed above, would use proposed Form SBS instead of the FOCUS Report Part II or Part IIA.

Customer Statements

Paragraph (c) of Rule 17a-5 requires, among other things, that certain broker-dealers annually send their customers audited statements that must include, among other things: (1) a statement of financial condition with appropriate notes; (2) a footnote containing a statement of the amount of the firm's net capital and required net capital and other information, if applicable, related to the firm's net capital;⁶³⁷ and (3) if, in connection with the most recent annual audit of the broker-dealer, the independent public accountant identified one or more material weaknesses, a statement by the broker-dealer that one or more material weaknesses have been identified and that a copy of the report of the independent public accountant is currently available for the customer's inspection.⁶³⁸ In addition, paragraph (c) requires these broker-dealers to send their customers unaudited statements dated six months from the date of the audited statements that

⁶³⁵ See 17 CFR 240.17a-5(b).

⁶³⁶ See paragraph (b) of Rule 17a-5, as proposed to be amended (emphasis added to highlight the modification). The Commission is not proposing to include a parallel requirement in proposed Rule 18a-7 applicable to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, or bank MSBSPs because such SBSDs and MSBSPs would not be eligible for membership in a national securities exchange or national securities association.

⁶³⁷ The statement in the footnote must include summary financial statements of the broker-dealer's subsidiaries consolidated pursuant to Appendix C of Rule 15c3-1, where material, and the effect thereof on the net capital and required net capital of the broker-dealer. See 17 CFR 240.17a-5(c)(2)(ii). Appendix C to Rule 15c3-1 requires a broker-dealer in computing its net capital and aggregate indebtedness to consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly obligations or liabilities. See 17 CFR 240.15c3-1c. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the broker-dealer may also be consolidated. See *id.*

⁶³⁸ See 17 CFR 240.17a-5(c)(1) and (2). A material weakness is discussed below in more detail.

contain: (1) a statement of financial condition with appropriate notes; and (2) a footnote about the firm's net capital as described above.⁶³⁹ Under paragraph (c)(5) of Rule 17a-5, a broker-dealer is exempt from sending the statement of financial condition to customers if the broker-dealer, among other things: (1) sends its customers semi-annually the statements described above relating to the firm's net capital and, if applicable, the identification of a material weakness; and (2) makes the statement of financial condition described above available on the broker-dealer's website home page and maintains a toll-free number that customers can call to request a copy of the statement, which the broker-dealer must send promptly to the customer at no charge.⁶⁴⁰

The Commission has stated that the information sent to a customer about the broker-dealer is "essential for a customer to have in order to judge" whether the broker-dealer is financially sound and able to efficiently and safely handle securities transactions, monies and securities.⁶⁴¹ The Commission preliminarily believes that it is not necessary to amend paragraph (c) of Rule 17a-5 to account for broker-dealers that are dually registered as an SBSD or MSBSP. These registrants will be required to send or disclose to their customers, including security-based swap customers, the information currently required to be sent or disclosed under paragraph (c).⁶⁴²

However, the Commission is proposing to include a parallel customer statement requirement in proposed Rule 18a-7 that is modeled on paragraph (c) of Rule 17a-5.⁶⁴³ Proposed

⁶³⁹ See 17 CFR 240.17a-5(c)(3).

⁶⁴⁰ See 17 CFR 240.17a-5(c)(5).

⁶⁴¹ See Reports to be Made by Certain Exchange Members, Brokers, and Dealers and Related Audit Requirements of Form X-17A-5, Exchange Act Release No. 9658 (June 30, 1972), 37 FR 14607, 14607 (July 21, 1972).

⁶⁴² See the broad definition of customer in paragraph (c)(4) of Rule 17a-5. See 17 CFR 240.17a-5(c)(4). As discussed below in section II.B.3.b. of this release, the Commission is proposing certain technical amendments to paragraph (c) of Rule 17a-5.

⁶⁴³ Compare 17 CFR 240.17a-5(c), with paragraph (b) of proposed Rule 18a-7.

Rule 18a-7, however, would require (rather than make optional) website disclosure of the mandated information.⁶⁴⁴ Specifically, stand-alone SBSDs and stand-alone MSBSPs would be required to disclose on their Internet websites an audited statement of financial condition with appropriate notes within ten business days after the date the firm is required to file its audited annual reports with the Commission.⁶⁴⁵ Website disclosure generally provides customers with readily accessible information that can be easily viewed at any time. Further, this form of disclosure generally is less expensive and burdensome than other forms of disclosure. Consequently, the Commission preliminarily anticipates that firms would opt for website disclosure if given the choice.

In addition to the audited statement of financial condition with appropriate notes, a stand-alone SBSd would be required to disclose on its Internet website at the same time: (1) a statement of the amount of the firm's net capital and required net capital and other information, if applicable, related to the firm's net capital;⁶⁴⁶ and (2) if, in connection with the firm's most recent annual reports, the report of the independent public accountant identifies one or more material weaknesses, a copy of the report.⁶⁴⁷ Further, stand-alone SBSDs and stand-alone

⁶⁴⁴ See paragraph (b) of proposed Rule 18a-7.

⁶⁴⁵ See paragraph (b)(1)(i) of proposed Rule 18a-7. As discussed in more detail below, the Commission is proposing to require nonbank SBSDs and nonbank MSBSPs to annually file audited financial reports with the Commission that would need to include, among other items, a statement of financial condition. Under paragraph (c)(2) of Rule 17a-5, a broker-dealer's audited statements must be sent to customers within 105 calendar days of the date of the broker-dealer's audited annual reports. See 17 CFR 240.17a-5(c)(2). Further, the broker-dealer's audited annual reports must be filed with the Commission within 60 calendar days after the end of the broker-dealer's fiscal year. See 17 CFR 240.17a-5(d)(5). Consequently, the broker-dealer has 45 calendar days after filing the audited annual reports with the Commission to send the audited financial statements to customers. The Commission is proposing a shorter timeframe (10 business days) in proposed Rule 18a-7 to make the web-based disclosures after filing the audited annual reports with the Commission because posting this information to the internet should take substantially less time than preparing mailings to be sent to all customers.

⁶⁴⁶ The statement would need to include summary financial statements of the broker-dealer's subsidiaries consolidated pursuant to Appendix C of Rule 15c3-1, where material, and the effect thereof on the net capital and required net capital of the SBSd. See paragraph (b)(1)(ii) of proposed Rule 18a-7.

⁶⁴⁷ See paragraph (b)(1)(iii) of proposed Rule 18a-7.

MSBSPs also would be required to disclose on their websites an unaudited statement of financial condition as of a date that is six months after the date of the most recent audited annual reports and the other information discussed above.⁶⁴⁸ This disclosure would need to be made within 30 calendar days of the date of the unaudited statement of financial condition.⁶⁴⁹ Finally, stand-alone SBSDs and stand-alone MSBSPs would be required to make the information required to be disclosed to customers on their websites under paragraph (b) of proposed Rule 18a-7 available in writing upon request of the customer and maintain a toll-free number to receive such requests.⁶⁵⁰

Annual Reports

Under the recent amendments to Rule 17a-5, paragraph (d) of the rule requires broker-dealers, among other things, to file with the Commission each year annual reports consisting of a financial report and either a compliance report or an exemption report, as well as reports that are prepared by an independent public accountant registered with the PCAOB covering the financial report and the compliance report or the exemption report in accordance with standards of the PCAOB.⁶⁵¹ The financial report must contain financial statements, including, among others, a statement of financial condition, a statement of income, and a statement of cash flows.⁶⁵² The financial report also must contain, as applicable, supporting schedules consisting of a

⁶⁴⁸ See paragraph (b)(2) of proposed Rule 18a-7.

⁶⁴⁹ The Commission is proposing a shorter time period (30 calendar days after the date of the unaudited financial statement as opposed to 65 calendar days) for the web-based disclosure of the unaudited financial statements and other statements, because, as discussed above, posting this information on a website should take less time than mailing documents. Compare paragraph (b)(2) of proposed Rule 18a-7, with 17 CFR 240.17a-5(c)(3).

⁶⁵⁰ See paragraph (b)(3) of proposed Rule 18a-7. While bank SBSDs and bank MSBSPs would not be subject to paragraph (b) of proposed Rule 18a-7, bank call reports are available at: http://www2.fdic.gov/Call_TFR_Rpts/. See 12 CFR 261.10(d)(3) and (4); 12 CFR 304.2; 12 CFR Pt. 3, Appendix C.

⁶⁵¹ See 17 CFR 240.17a-5(d). See also Broker-Dealer Reports, 78 FR 51910 (setting forth the effective dates for the amendments).

⁶⁵² See 17 CFR 240.17a-5(d)(2)(i).

computation of net capital under Rule 15c3-1, a computation of the reserve requirements under Rule 15c3-3, and information relating to the possession or control requirements under Rule 15c3-3.⁶⁵³

A broker-dealer that does not claim it was exempt from Rule 15c3-3 throughout the most recent fiscal year must file the compliance report, and a broker-dealer that does claim it was exempt from Rule 15c3-3 throughout the most recent fiscal year must file the exemption report.⁶⁵⁴ The compliance report must contain statements as to whether: (1) the broker-dealer has established and maintained Internal Control Over Compliance (a defined term); (2) the Internal Control Over Compliance of the broker-dealer was effective during the most recent fiscal year; (3) the Internal Control Over Compliance of the broker-dealer was effective as of the end of the most recent fiscal year; (4) the broker-dealer was in compliance with Rule 15c3-1 and paragraph (e) of Rule 15c3-3 as of the end of the most recent fiscal year; and (5) the information the broker-dealer used to state whether it was in compliance with Rule 15c3-1 and paragraph (e) of Rule 15c3-3 was derived from the books and records of the broker-dealer.⁶⁵⁵ Further, if applicable, the compliance report must contain a description of: (1) each identified material weakness (a defined term) in the Internal Control Over Compliance during the most recent fiscal year; and (2) each instance of non-compliance with Rule 15c3-1 or paragraph (e) of Rule 15c3-3 as of the end of the most recent fiscal year.⁶⁵⁶ The exemption report must contain the following

⁶⁵³ See 17 CFR 240.17a-5(d)(2)(ii).

⁶⁵⁴ See 17 CFR 240.17a-5(d)(1)(i)(B)(1) and (2).

⁶⁵⁵ See 17 CFR 240.17a-5(d)(3)(i)(A). The term Internal Control Over Compliance means internal controls that have the objective of providing the broker-dealer with reasonable assurance that non-compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or any rule of the DEA of the broker-dealer that requires account statements to be sent to the customers of the broker-dealer (an "Account Statement Rule") will be prevented or detected on a timely basis. See 17 CFR 240.17a-5(d)(3)(i).

⁶⁵⁶ See 17 CFR 240.17a-5(d)(3)(i)(B) and (C). A material weakness is a deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with Rule 15c3-1 or paragraph (e) of Rule 15c3-3 will not be prevented or detected on a timely

statements made to the best knowledge and belief of the broker-dealer: (1) a statement that identifies the provisions in paragraph (k) of Rule 15c3-3 under which the broker-dealer claimed an exemption from Rule 15c3-3; (2) a statement that the broker-dealer met the identified exemption provisions without exception or that it met the identified exemption provisions throughout the most recent fiscal year except as described in the exemption report; and (3) if applicable, a statement that identifies each exception during the most recent fiscal year in meeting the exemption provisions and that briefly describes the nature of each exception and the approximate date(s) on which the exception existed.⁶⁵⁷

The Commission is proposing amendments to the requirements in paragraph (d) of Rule 17a-5 that require broker-dealers to file annual reports with the Commission and is proposing to include a parallel requirement in proposed Rule 18a-7 to require stand-alone SBSDs and stand-alone MSBSPs to file annual reports with the Commission.⁶⁵⁸ The amendments to paragraph (d) of Rule 17a-5 are designed to account for broker-dealers that are dually registered as an SBSD or MSBSP.

First, under the proposals, all broker-dealer SBSDs would be required to file the compliance report. It is likely that a broker-dealer SBSD would carry funds and securities of customers and, therefore, would not be exempt from Rule 15c3-3. In this case, under the recently adopted requirements of Rule 17a-5, the broker-dealer SBSD would be required to file the compliance report. The Commission believes that a broker-dealer SBSD that has only

basis or that non-compliance to a material extent with Rule 15c3-3, except for paragraph (e), Rule 17a-13, or any Account Statement Rule will not be prevented or detected on a timely basis. A deficiency in Internal Control Over Compliance exists when the design or operation of a control does not allow the management or employees of the broker-dealer, in the normal course of performing their assigned functions, to prevent or detect on a timely basis non-compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or any Account Statement Rule.

⁶⁵⁷ See 17 CFR 240.17a-5(d)(4).

⁶⁵⁸ Compare paragraph (d) of Rule 17a-5, as proposed to be amended, with paragraph (c) of proposed Rule 18a-7.

security-based swap customers also should be required to file the compliance report because this report and the related report of the independent public accountant covering the compliance report would serve the same customer protection objectives in terms of promoting compliance with proposed Rule 18a-4 as these reports will serve in terms of promoting compliance with Rule 15c3-3.⁶⁵⁹ For this reason, the Commission is proposing to amend paragraph (d)(1)(i)(B)(1) of Rule 17a-5 to provide that a broker-dealer must file the compliance report if it did not claim it was exempt from Rule 15c3-3 throughout the most recent fiscal year or it is subject to proposed Rule 18a-4.⁶⁶⁰ Further, paragraph (d)(1)(i)(B)(2) of Rule 17a-5 would be amended to provide that a broker-dealer must file the exemption report if the broker-dealer did claim it was exempt from Rule 15c3-3 throughout the most recent fiscal year and it is not subject to proposed Rule 18a-4.⁶⁶¹

Second, paragraph (d) of Rule 17a-5 provides that the financial statements in the financial report must be prepared in accordance with U.S. GAAP and must be in a format that is consistent with, and the supporting schedules must include information from, the FOCUS Report Part II or Part IIA.⁶⁶² Further, the supporting schedules must contain a reconciliation if the computation of net capital under Rule 15c3-1 or the customer reserve requirement under Rule 15c3-3 in the supporting schedule is materially different than computation in the broker-dealer's most recent FOCUS Report Part II or Part IIA.⁶⁶³ The amendments to the reporting requirements in paragraph (d) of Rule 17a-5 would add a reference to proposed Rule 18a-4 to be included with the existing references to Rules 15c3-1 and 15c3-3, and to proposed Form SBS to be included

⁶⁵⁹ See Broker-Dealer Reports, 78 FR at 51916–51920.

⁶⁶⁰ See paragraph (d)(1)(i)(B)(1) of Rule 17a-5, as proposed to be amended.

⁶⁶¹ See paragraph (d)(1)(i)(B)(2) of Rule 17a-5, as proposed to be amended.

⁶⁶² See 17 CFR 240.17a-5(d)(2)(i) and (ii).

⁶⁶³ See 17 CFR 240.17a-5(d)(2)(iii).

with each reference to the FOCUS Report Part II and Part IIA to account for broker-dealer SBSDs and broker-dealer MSBSPs that would use proposed Form SBS rather than the FOCUS Report Part II or Part IIA.⁶⁶⁴

Third, as discussed above, the supporting schedules require a computation of the reserve requirements under Rule 15c3-3 and information relating to the possession or control requirements under Rule 15c3-3.⁶⁶⁵ Further, the statements required in the compliance report and the definitions of Internal Control Over Compliance and material weakness for the purposes of the compliance report make reference to Rule 15c3-3 or paragraph (e) of Rule 15c3-3.⁶⁶⁶ The proposed amendments would add references to proposed Rule 18a-4 generally or to specific parallel requirements in proposed Rule 18a-4 so that the supporting schedule and compliance report requirements would incorporate information relating to proposed Rule 18a-4 in addition to information relating to Rule 15c3-3.⁶⁶⁷

As indicated above, the Commission is proposing to include parallel annual reporting requirements in proposed Rule 18a-7 applicable to stand-alone SBSDs and stand-alone MSBSPs that are modeled on paragraph (d) of Rule 17a-5, as proposed to be amended.⁶⁶⁸ Under these proposed parallel requirements, stand-alone SBSDs and stand-alone MSBSPs would be required to annually file with the Commission a financial report.⁶⁶⁹ In addition, stand-alone SBSDs would be required to file a compliance report stating that the SBSD has established and maintains internal controls that have the objective of providing reasonable assurance that non-

⁶⁶⁴ See paragraphs (d)(2)(i) through (iii) of Rule 17a-5, as proposed to be amended.

⁶⁶⁵ See 17 CFR 240.17a-5(d)(2)(ii).

⁶⁶⁶ See 17 CFR 240.17a-5(d)(3)(i) through (iii).

⁶⁶⁷ See paragraphs (d)(2)(ii) and (iii) and (d)(3)(i) through (iii) of Rule 17a-5, as proposed to be amended.

⁶⁶⁸ Compare paragraphs (d)(1) through (3) of Rule 17a-5, as proposed to be amended, with paragraphs (c)(1) through (3) of proposed Rule 18a-7.

⁶⁶⁹ See paragraph (c)(1)(i)(A) of proposed Rule 18a-7.

compliance with Rules 18a-1, 18a-4, and 18a-9 will be prevented or detected on a timely basis.⁶⁷⁰

Further, stand-alone SBSDs and stand-alone MSBSPs would be required to file a report of an independent public accountant covering the financial report and the compliance report, as applicable.⁶⁷¹ The Commission is not proposing to include a requirement in proposed Rule 18a-7 that would parallel the exemption report requirement in Rule 17a-5 because there are no exemption provisions in proposed Rule 18a-4 that parallel the exemption provisions in Rule 15c3-3.⁶⁷²

The financial report under Rule 18a-7 would need to contain the same types of financial statements as are required for the financial report under Rule 17a-5.⁶⁷³ Further, it also would need to contain the same types of supporting schedules and reconciliations as the financial report under Rule 17a-5, as proposed to be amended, except that the Rule 18a-7 financial report would require information relating to Rules 18a-1 and 18a-2, as applicable, rather than Rule 15c3-1.⁶⁷⁴ The financial report under Rule 17a-5, as proposed to be amended, and proposed Rule 18a-7 would require information relating to proposed Rule 18a-4.

Similar to the financial report, the compliance report under Rule 18a-7 would need to contain the same type of statements and information as the compliance report under Rule 17a-5, as proposed to be amended, except the Rule 18a-7 compliance report would require information relating to Rules 18a-1 and 18a-9 rather than Rules 15c3-1, Rule 15c3-3, Rule 17a-13, and the

⁶⁷⁰ See paragraph (c)(1)(i)(B) of proposed Rule 18a-7.

⁶⁷¹ See paragraph (c)(1)(i)(C) of proposed Rule 18a-7.

⁶⁷² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70274-70288.

⁶⁷³ Compare 17 CFR 240.17a-5(d)(2)(i), with paragraph (c)(2)(i) of proposed Rule 18a-7.

⁶⁷⁴ Compare Rule 17a-5, as proposed to be amended, with paragraph (c)(2)(ii) and (iii) of proposed Rule 18a-7.

Account Statement Rules.⁶⁷⁵ The compliance report under Rule 17a-5, as proposed to be amended, and proposed Rule 18a-7 would require information relating to proposed Rule 18a-4.

Timing and Location of Filing

Paragraph (d)(5) of Rule 17a-5 provides that a broker-dealer must file the annual reports with the Commission not more than sixty calendar days after the end of the fiscal year of the broker-dealer.⁶⁷⁶ The Commission is proposing to include a parallel requirement in proposed Rule 18a-7 that would mirror paragraph (d)(5) of Rule 17a-5.⁶⁷⁷ Consequently, stand-alone SBSDs and stand-alone MSBSPs would be required to file the annual reports required under proposed Rule 18a-7 within 60 calendar days after the end of their fiscal years.⁶⁷⁸

Paragraph (d)(6) of Rule 17a-5 provides that a broker-dealer must file the annual reports: (1) at the office of the Commission for the region where the broker-dealer has its principal place of business; (2) at the Commission's principal office in Washington, DC; (3) at the principal office of the broker-dealer's DEA; and (4) with SIPC.⁶⁷⁹ The Commission is proposing to include a parallel requirement in proposed Rule 18a-7 that is modeled on paragraph (d)(5) of Rule 17a-5.⁶⁸⁰ In particular, paragraph (c)(5) of proposed Rule 18a-5 would require stand-alone SBSDs and stand-alone MSBSPs to file the annual reports at the regional office of the

⁶⁷⁵ Compare 17 CFR 240.17a-5(d)(3), with paragraph (c)(3) of proposed Rule 18a-7.

⁶⁷⁶ See 17 CFR 240.17a-5(d)(5).

⁶⁷⁷ Compare 17 CFR 240.17a-5(d)(5), with paragraph (c)(4) of proposed Rule 18a-7.

⁶⁷⁸ See paragraph (c)(4) of proposed Rule 18a-7.

⁶⁷⁹ See 17 CFR 240.17a-5(d)(6). Paragraph (d)(6) further provides that the broker-dealer must provide copies of the reports to all SROs of which the broker-dealer is a member, unless the SRO by rule waives this requirement. See *id.*

⁶⁸⁰ Compare 17 CFR 240.17a-5(d)(6), with paragraph (c)(5) of proposed Rule 18a-7.

Commission for the region in which the SBSD or MSBSP has its principal place of business and the Commission's principal office in Washington, DC.⁶⁸¹

Nature and Form of the Reports

Paragraph (e) of Rule 17a-5 among other things: (1) provides certain exceptions from the requirement that a broker-dealer engage an independent public accountant to audit the annual reports, (2) requires the broker-dealer to attach an oath or affirmation to the financial reports; (3) provides that the annual reports are not confidential except that the broker-dealer can request confidentiality for all of the annual reports other than the statement of financial condition; and (4) requires a broker-dealer to file certain additional reports with SIPC.⁶⁸²

Paragraph (e)(2) of Rule 17a-5 requires a broker-dealer to attach an oath or affirmation to its financial report indicating that the report is true and correct and that the broker-dealer does not have any proprietary interest in one of its customer accounts.⁶⁸³ Paragraph (e)(2) also requires that the oath or affirmation must be made before a person duly authorized to administer such oaths or affirmations and prescribes who must make the oath or affirmation on behalf of the broker-dealer.⁶⁸⁴ The Commission adopted the FOCUS Report Part III as the means for the broker-dealer to provide the oath or affirmation required under paragraph (e)(2).⁶⁸⁵ The FOCUS

⁶⁸¹ See paragraph (c)(5) of proposed Rule 18a-7. There would be no requirement to file the reports with SIPC or a DEA because stand-alone SBSDs and stand-alone MSBSPs would not be members of SIPC and would not have a DEA.

⁶⁸² See 17 CFR 240.17a-5(e).

⁶⁸³ See 17 CFR 240.17a-5(e)(2).

⁶⁸⁴ See 17 CFR 240.17a-5(e)(2). If the broker or dealer is a sole proprietorship, the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; if a corporation, by a duly authorized officer; or if a limited liability company or limited liability partnership, by the chief executive officer, chief financial officer, manager, managing member, or those members vested with management authority for the limited liability company or limited liability partnership. *Id.*

⁶⁸⁵ See 17 CFR 242.617. See also FOCUS Reporting System; Requirements for Financial Reporting, Exchange Act Release No. 14242 (Dec. 9, 1977), 42 FR 63883 (Dec. 21, 1977) ("The Commission proposed the facing page for the annual report based on its experience that the processing of the annual report would be greatly facilitated if the identification information were submitted in a consistent format.

Report Part III elicits certain basic information about the broker-dealer and the independent public accountant (e.g., name and address), contains a checklist to indicate the statements and other information included in the annual reports, and sets forth the text of the oath or affirmation required under paragraph (e)(2) of Rule 17a-5.⁶⁸⁶

The Commission is proposing to amend paragraph (e)(2) of Rule 17a-5 to remove the text of the oath or affirmation because the text of oath or affirmation is set forth on the FOCUS Report Part III.⁶⁸⁷ The proposed amendments also would state explicitly in the text of Rule 17a-5 that a broker-dealer is required to attach a complete and executed FOCUS Report Part III to the confidential and non-confidential portions of the annual reports filed with the Commission.⁶⁸⁸

In addition, the Commission is proposing a number of amendments to the FOCUS Report Part III to accommodate use of the FOCUS Report Part III by OTC derivatives dealers, stand-alone SBSDBs, and stand-alone MSBSPs.⁶⁸⁹ The Commission also proposes amendments

The proposed facing page requires basic identification information, including the...name and address of the broker or dealer and its accountant, the oath or affirmation, and the itemization of the materials included in the report.”). See also FOCUS Report Part III, available at http://www.sec.gov/about/forms/formx-17a-5_3.pdf.

⁶⁸⁶ See FOCUS Report Part III.

⁶⁸⁷ Compare 17 CFR 240.17a-5(e)(2), with paragraph (e)(2) of Rule 17a-5, as proposed to be amended.

⁶⁸⁸ See paragraph (e)(2) of Rule 17a-5, as proposed to be amended.

⁶⁸⁹ These amendments would: (1) add a reference to Rule 17a-12 and proposed Rule 18a-7 to the subtitle; (2) remove the phrase “Name of Broker-Dealer” and in its place add the phrase “Name of Firm” in section A; (3) add check boxes to section A for the filer to indicate whether it is registered as an OTC derivatives dealer, broker-dealer, SBSDB, and/or MSBSP; (4) add to the check list at the end of the Form boxes to indicate whether the annual reports attached to the Form include: (i) a computation of net capital pursuant to proposed Rule 18a-1; (ii) a computation of tangible net worth under Rule 18a-2; (iii) a computation for determination of reserve requirements pursuant to proposed Rule 18a-4; (iv) information relating to possession or control requirements under proposed Rule 18a-4; (v) a reconciliation, including appropriate explanation of the computation of net capital under proposed Rule 18a-1; (vi) a reconciliation, including appropriate explanation of the computation of tangible net worth under proposed Rule 18a-2; (vii) a reconciliation, including appropriate explanation of the computation of reserve requirements under proposed Rule 18a-4; (viii) an independent public accountant’s report based on an examination of the financial statements under Rule 17a-12; (ix) an independent public accountant’s report based on an examination of the financial report under proposed Rule 18a-7; and (x) an independent public accountant’s

to Part III of the FOCUS Report to address the recently adopted amendments to Rule 17a-5.⁶⁹⁰

Further, the Commission is proposing a number of technical changes to the FOCUS Report Part III.⁶⁹¹

The Commission is proposing to add a reference to proposed Form SBS to the references to the FOCUS Report Part II and Part IIA in paragraph (e)(3) of Rule 17a-5 to account for broker-dealers that are dually registered as an SBSB or MSBSP and, therefore, would use proposed Form SBS instead of the FOCUS Report Part II or Part IIA.⁶⁹²

The Commission is proposing to include parallel provisions in proposed Rule 18a-7 to the provisions in paragraph (e) of Rule 17a-5, as proposed to be amended. Under these provisions, stand-alone SBSBs and stand-alone MSBSPs would be required to attach a

report based on an examination of the compliance report under proposed Rule 18a-7; and (5) replace the check box entitled "A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3" with two check boxes entitled: (i) "A reconciliation, including appropriate explanation of the computation of net capital under 17 C.F.R. § 240.15c3-1"; and (ii) A reconciliation, including appropriate explanation of the computation of net capital under 17 C.F.R. § 240.15c3-3. See Part III of the FOCUS Report, as proposed to be amended. The proposals also would amend the instructions at the end of the Form with respect to seeking confidential treatment for portions of the annual reports by adding a reference to the provisions of proposed Rule 18a-7 governing how to request confidential treatment and replacing the phrase "For conditions of" with the phrase "To request." Id.

⁶⁹⁰ See Broker-Dealer Reports, 78 FR 51910. These amendments would: (1) add the phrase "PCAOB-Registered" before the phrase "Independent Public Accountant" in section B; (2) remove check boxes in section B to indicate whether the independent public accountant is certified, a public accountant, or an accountant not registered in the U.S.; (3) add to the check list at the end of the Form boxes to indicate whether the annual reports attached to the Form include: (i) the exemption report under Rule 17a-5; (ii) the compliance report under Rule 17a-5; (iii) the independent public accountant's report based on an examination of the financial report under Rule 17a-5; (iv) the independent public accountant's report based on the examination of the compliance report, as required by Rule 17a-5; or (v) the independent public accountant's report based on the review of the exemption report under Rule 17a-5. See Part III of the FOCUS Report, as proposed to be amended. The amendments also would remove from the checklist an item to indicate whether any material inadequacies under Rule 17a-5 were found to exist or found to have existed since the date of the previous audit. See id.

⁶⁹¹ The proposed technical amendments are as follows: (1) removing the phrase "See Section 240.17a-5(e)(2)" in the instruction for broker-dealers that claim an exemption from the requirement that the annual report be covered by an opinion of an independent public accountant and in its place adding the phrase "See 17 CFR 240.17a-5(e)(1)(ii), if applicable."; and (2) removing the "Statement of Changes in Financial Condition" from the checklist and in its place adding the phrase "Statement of cash flows".

⁶⁹² See paragraph (e)(3) of Rule 17a-5, as proposed to be amended.

completed and executed FOCUS Report Part III to the confidential and non-confidential portions of the annual report.⁶⁹³ In addition, paragraph (d)(2) of proposed Rule 18a-7 would provide that the annual reports are not confidential except that if the statement of financial condition is bound separately from the balance of the annual reports and each page of the balance of the annual reports is stamped "confidential", then the balance of the annual reports will be deemed confidential to the extent permitted by law.⁶⁹⁴ Paragraph (d)(2) of proposed Rule 18a-7 would mirror the confidential treatment of broker-dealer annual reports under Rule 17a-5.⁶⁹⁵

Qualification of the Independent Public Accountant

As discussed above, a broker-dealer is required to file with the Commission a report of a PCAOB-registered independent public accountant covering the annual reports.⁶⁹⁶ Paragraph (f) of Rule 17a-5: (1) prescribes certain minimum qualifications for the independent public accountant; (2) requires the broker-dealer to file with the Commission a statement concerning the accountant; and (3) requires the broker-dealer to file a notice when replacing the independent public accountant.⁶⁹⁷

More specifically, paragraph (f)(1) of Rule 17a-5 provides that the independent public accountant must be qualified and independent in accordance with the independence requirements of Rule 2-01 of Regulation S-X and registered with the PCAOB if required by the Sarbanes-Oxley Act of 2002.⁶⁹⁸

⁶⁹³ Compare paragraph (e)(2) of Rule 17a-5, as proposed to be amended, with paragraph (d)(1) of proposed Rule 18a-7.

⁶⁹⁴ See paragraph (d)(2) of proposed Rule 18a-7.

⁶⁹⁵ Compare 17 CFR 240.17a-5(e)(3), with paragraph (d)(2) of proposed Rule 18a-7.

⁶⁹⁶ See 17 CFR 240.17a-5(d)(1)(i)(C).

⁶⁹⁷ See 17 CFR 240.17a-5(f).

⁶⁹⁸ See 17 CFR 240.17a-5(f)(1). See also 15 U.S.C 78q(e)(1)(A); 17 CFR 210.2-01. Prior to the Sarbanes-Oxley Act, section 17(e)(1)(A) of the Exchange Act required that the annual financial statements a broker-dealer must file with the Commission be "certified by an independent public accountant." The Sarbanes-

Paragraph (f)(2) requires a broker-dealer to annually file with the Commission no later than December 10 a statement regarding the independent public accountant engaged to audit its annual reports.⁶⁹⁹ The statement must contain, among other things: (1) the name, address, telephone number, and registration number of the broker-dealer; (2) the name, address, and telephone number of the independent public accountant; (3) the date of the fiscal year of the annual reports of the broker-dealer covered by the engagement; (4) whether the engagement is for a single year or is of a continuing nature; and (5) a representation that the independent public

Oxley Act established the PCAOB and amended section 17(e)(1)(A) to provide that the annual financial statements must be "certified by a registered [with the PCAOB] public accounting firm." See Sarbanes-Oxley Act, Pub. L. 107-204, 101, 116 Stat. 745 (2002); 15 U.S.C 78q(e)(1)(A). Title I of the Sarbanes-Oxley Act prescribed specific PCAOB registration, standards-setting, inspection, investigation, disciplinary, foreign application, oversight, and funding programs in connection with audits of issuers. See Pub. L. 107-204 generally and, in particular, § 2(a)(7) (defining the term issuer as an issuer as defined in section 3 of the Exchange Act, the securities of which are registered under section 12 of the Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 and that it has not withdrawn). However, as originally enacted, the Sarbanes-Oxley Act did not expressly prescribe similar programs in connection with audits of broker-dealers that are not issuers. The Dodd-Frank Act amended the Sarbanes-Oxley Act to provide the PCAOB with explicit authority to, among other things, establish (subject to Commission approval) auditing and related attestation, quality control, ethics, and independence standards for registered public accounting firms with respect to their preparation of audit reports to be included in broker-dealer filings with the Commission, and the authority to conduct and require an inspection program of registered public accounting firms that audit broker-dealers. See Pub. L. 111-203, 982. Further, the Dodd-Frank Act amended section 17(e) of the Exchange Act to provide, among other things, that a broker-dealer must annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered (with the PCAOB) public accounting firm if the firm is required to be registered (with the PCAOB) under the Sarbanes-Oxley Act of 2002. See Pub. L. 111-203, 982(e)(1); 15 U.S.C 78q(e)(1). Additionally, the Dodd-Frank Act added section 104(a)(2)(D) to the Sarbanes-Oxley Act, which provides that a public accounting firm is not required to register with the PCAOB if the public accounting firm is exempt from an inspection program established by the PCAOB. See id. To date, the PCAOB has not exempted the audits by independent public accountants of any class of broker-dealer from the PCAOB's permanent inspection program. See Public Company Accounting Oversight Board; Order Approving Proposed Temporary Rule for an Interim Program of Inspection Related to Audits of Brokers and Dealers, Exchange Act Release No. 65163 (Aug. 18, 2011), 76 FR 52996 (Aug. 24, 2011). At this time, there is no reason to expect that any types of broker-dealer audits will be exempt from the PCAOB permanent inspection program, and any PCAOB determination to exempt broker-dealer audits from the PCAOB's permanent inspection program must be approved by the Commission.

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See 17 CFR 240.17a-5(f)(2). Paragraph (f)(2) further provides that if the engagement of an independent public accountant is of a continuing nature, providing for successive engagements, no further filing is required after the original filing. See id. On the other hand, if the engagement is for a single year, or if the most recent engagement has been terminated or amended, a new statement must be filed by the required date. See id.

accountant has undertaken to prepare reports covering the annual reports as required by paragraph (g) of Rule 17a-5.⁷⁰⁰

Paragraph (f)(3) of Rule 17a-5 requires a broker-dealer to file a notice with the Commission if it replaces the independent public accountant engaged to prepare reports covering the annual reports.⁷⁰¹ The notice must contain, among other things: (1) the date of the notification of termination or the engagement of the new independent public accountant; (2) the details of any issues arising during the twenty-four months (or the period of the engagement, if less than twenty-four months) preceding the termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure, or compliance with applicable rules of the Commission; and (3) whether the accountant's report covering the annual reports for any of the past two fiscal years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles, and must describe the nature of each such adverse opinion, disclaimer of opinion, or qualification.⁷⁰²

Broker-dealer SBSDs and broker-dealer MSBSPs will be required to engage independent public accountants that meet the qualifications in Rule 17a-5 and file the statements and notices

⁷⁰⁰ See 17 CFR 240.17a-5(f)(2). Under the recent amendments to Rule 17a-5, broker-dealers that clear transactions or carry customer accounts must include certain representations in the statement as well. See Broker-Dealer Reports, 78 FR 51992-51993.

⁷⁰¹ See 17 CFR 240.17a-5(f)(3). The notice must be received at the Commission's principal office in Washington, DC and at the applicable regional office of the Commission not more than fifteen days after: (1) the broker-dealer has notified the independent public accountant that provided the reports covering the annual reports for the most recent fiscal year that the independent public accountant's services will not be used in future engagements; (2) the broker-dealer has notified an independent public accountant that was engaged to provide the reports covering the annual reports that the engagement has been terminated; (3) an independent public accountant has notified the broker-dealer that the independent public accountant would not continue under an engagement to provide the reports covering the annual reports; or (4) a new independent public accountant has been engaged to provide the reports covering the annual reports without any notice of termination having been given to or by the previously engaged independent public accountant. See id.

⁷⁰² See 17 CFR 240.17a-5(f)(3).

required by the rule. The Commission is proposing to include in proposed Rule 18a-7 parallel independent public accountant qualification, statement, and notice requirements applicable to stand-alone SBSs and stand-alone MSBSs that are modeled on the requirements in paragraph (f) of Rule 17a-5.⁷⁰³

Paragraph (e)(1) of proposed Rule 18a-7 is modeled on paragraph (f)(1) of Rule 17a-5.⁷⁰⁴ Paragraph (e)(1) would provide that an independent public accountant engaged by a stand-alone SBS or stand-alone MSBS must be qualified and independent in accordance with Rule 2-01 of Regulation S-X and registered with the PCAOB.⁷⁰⁵ While the PCAOB's authority with respect to audits of stand-alone SBSs and stand-alone MSBSs would be more limited than its authority with respect to audits of issuers and broker-dealers, the Commission preliminarily believes that it would be appropriate to require stand-alone SBSs and stand-alone MSBSs to

⁷⁰³ Compare 17 CFR 240.17a-5(f), with paragraph (e) of proposed Rule 18a-7.

⁷⁰⁴ Compare 17 CFR 240.17a-5(f)(1), with paragraph (e)(1) of proposed Rule 18a-7.

⁷⁰⁵ See paragraph (e)(1) of proposed Rule 18a-7. With respect to qualifications, paragraph (a) of Rule 2-01 provides that the Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of the accountant's residence or principal office. See 17 CFR 210.2-01(a). Paragraph (a) further provides that the Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of the accountant's residence or principal office. See *id.* With respect to independence, paragraph (b) of Rule 2-01 provides that the Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. See 17 CFR 210.2-01(b). Paragraph (b) further provides that in determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission. See *id.* Paragraph (c) of Rule 2-01 sets forth a non-exclusive specification of circumstances inconsistent with independence as required under paragraph (b). See 17 CFR 210.2-01(c). For example, an accountant is prohibited from providing the following non-audit services, among others, to an audit client: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation; and (3) management functions or human resources. See *id.* Not all of the independence requirements in Rule 2-01 that are applicable to audits of issuers would be applicable to engagements under proposed Rule 18a-7. For example, the independent public accountants of stand-alone SBSs and stand-alone MSBSs that are not issuers would not be subject to the partner rotation requirements or the compensation requirements of Rule 2-01 because the statute mandating those requirements is limited to issuers. See 15 U.S.C. 78j-1(j); 17 CFR 210.2-01(c)(6). Additionally, the independent public accountants would not be subject to the cooling-off period requirements for employment or the audit committee pre-approval requirements because those requirements only reference issuers within the independence rules. See 17 CFR 210.2-01(c)(2) and (c)(7).

engage an independent public accountant that is registered with the PCAOB.⁷⁰⁶ In particular, the Commission has greater confidence in the quality of audits conducted by an independent public accountant registered with the PCAOB.⁷⁰⁷

Paragraph (e)(2) of proposed Rule 18a-7 is modeled on paragraph (f)(2) of Rule 17a-5.⁷⁰⁸ Under paragraph (e)(2), a stand-alone SBSB or stand-alone MSBSP would be required to annually file with the Commission no later than December 10 a statement regarding the independent public accountant engaged to audit its annual reports.⁷⁰⁹ The statement would need to contain similar information as is required in the statement under paragraph (f)(2) of Rule 17a-5.⁷¹⁰

Paragraph (e)(3) of proposed Rule 18a-7 is modeled on paragraph (f)(3) of Rule 17a-5.⁷¹¹ Under paragraph (e)(3), a stand-alone SBSB or stand-alone MSBSP would be required to file a notice with the Commission if the firm replaces the independent public accountant engaged to prepare the reports covering the annual reports.⁷¹² The notice would need to contain the same information as is required in the notice under paragraph (f)(3) of Rule 17a-5.⁷¹³

⁷⁰⁶ See Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456 (Jan. 11, 2010) (adopting rules requiring certain investment advisers to undergo annual surprise examinations performed by, and obtain internal control reports prepared by, independent public accountants registered with the PCAOB).

⁷⁰⁷ See *id.* at 1460.

⁷⁰⁸ Compare 17 CFR 240.17a-5(f)(2), with paragraph (e)(2) of proposed Rule 18a-7.

⁷⁰⁹ See paragraph (e)(2) of proposed Rule 18a-7. Like paragraph (f)(2) of Rule 17a-5, paragraph (e)(2) of proposed Rule 18a-7 would provide that if the engagement of an independent public accountant is of a continuing nature, providing for successive engagements, no further filing would be required. See *id.* Further, if the engagement is for a single year, or if the most recent engagement has been terminated or amended, a new statement would need to be filed by the required date. See *id.*

⁷¹⁰ Compare 17 CFR 240.17a-5(f)(2), with paragraph (e)(2) of proposed Rule 18a-7.

⁷¹¹ Compare 17 CFR 240.17a-5(f)(3), with paragraph (e)(3) of proposed Rule 18a-7.

⁷¹² See paragraph (e)(3) of proposed Rule 18a-7. Like paragraph (f)(3) of Rule 17a-5, paragraph (e)(3) of proposed Rule 18a-7 would require that the notice must be received at the Commission's principal office in Washington, DC and at the applicable regional office of the Commission not more than 15 days after: (1) the stand-alone SBSB or stand-alone MSBSP has notified the independent public accountant that provided the reports covering the annual reports for the most recent fiscal year that the independent public

Engagement of the independent public accountant

Under the recent amendments to Rule 17a-5, paragraph (g) of the rule provides that the independent public accountant engaged by the broker-dealer to provide the reports covering the annual reports must, as part of the engagement, undertake to prepare the following reports, as applicable, in accordance with PCAOB standards: (1) a report based on an examination of the financial report; and (2) either a report based on an examination of certain statements in the compliance report or a report based on a review of the exemption report.⁷¹⁴ As broker-dealers, dually registered broker-dealer SBSBs and broker-dealer MSBSBs will be required to engage their independent public accountants to undertake an examination of their financial report and compliance report.

accountant's services will not be used in future engagements; (2) the stand-alone SBSB or stand-alone MSBSB has notified an independent public accountant that was engaged to provide the reports covering the annual reports that the engagement has been terminated; (3) an independent public accountant has notified the stand-alone SBSB or stand-alone MSBSB that the independent public accountant would not continue under an engagement to provide the reports covering the annual reports; or (4) a new independent public accountant has been engaged to provide the reports covering the annual reports without any notice of termination having been given to or by the previously engaged independent public accountant. See id.

⁷¹³ Compare 17 CFR 240.17a-5(f)(3), with paragraph (e)(3) of proposed Rule 18a-7.

⁷¹⁴ See 17 CFR 240.17a-5(g). The PCAOB recently adopted, and the Commission approved, standards for examinations of compliance reports of broker-dealers and reviews of exemption reports of broker-dealers and for audits of supplemental information accompanying financial statements. See Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules, Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards, Exchange Act Release No. 71524 (Feb. 12, 2014). See also PCAOB, Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission, PCAOB Release No. 2013-007 (Oct. 10, 2013), available at http://pcaobus.org/Rules/Rulemaking/Docket035/PCAOB_Release_2013_007.pdf; PCAOB. The PCAOB also recently adopted, and the Commission approved Auditing Standard No. 17, which applies when the auditor of a company's financial statements is engaged to perform audit procedures and report on supplemental information that accompanies financial statements, including supporting schedules that broker-dealers are required to file pursuant to Rule 17a-5 under the Exchange Act. See Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules, Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, and Related Amendments to PCAOB Standards, Exchange Act Release No. 71525 (Feb. 12, 2014). See also, PCAOB, Auditing Standard No. 17: Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards, PCAOB Release No. 2013-008 (Oct. 10, 2013), available at http://pcaobus.org/Rules/Rulemaking/Docket036/PCAOB_Release_2013_008.pdf.

The Commission is proposing to include parallel engagement of accountant requirements in proposed Rule 18a-7 that would be applicable to stand-alone SBSs and stand-alone MSBSs that are modeled on the requirements in paragraph (g) of Rule 17a-5.⁷¹⁵ Specifically, paragraph (f) of proposed Rule 18a-7 would provide that the independent public accountant engaged by a stand-alone SBS or stand-alone MSBS must, as part of the engagement, undertake to prepare a report based on an examination of the financial report and, in the case of the SBS, a report based on an examination of certain statements in the compliance report.⁷¹⁶ There would not be a provision relating to an exemption report because, as explained above, broker-dealer SBSs and stand-alone SBSs would be required to file the compliance report (and would not be permitted to file the exemption report in lieu of the compliance report).

Notification of non-compliance or material weakness

Under the recent amendments to Rule 17a-5, paragraph (h) of the rule provides that the independent public accountant engaged to prepare reports covering the annual reports must immediately notify the broker-dealer if the accountant determines during the course of preparing the reports that the broker-dealer is not in compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or an Account Statement Rule or if the accountant determines that any material weakness exists in the broker-dealer's Internal Control Over Compliance.⁷¹⁷ If the notice from the accountant concerns an instance of non-compliance that would require a broker-dealer to provide a notification under Rule 15c3-1, Rule 15c3-3, or Rule 17a-11, or if the notice concerns a material weakness, the broker-dealer must provide a notification in accordance with Rule 15c3-1, Rule 15c3-3, or Rule 17a-11, as applicable, and provide a copy of the notification to the

⁷¹⁵ Compare 17 CFR 240.17a-5(g), with paragraph (f) of proposed Rule 18a-7.

⁷¹⁶ See paragraph (f) of proposed Rule 18a-7.

⁷¹⁷ See 17 CFR 240.17a-5(h). The term material weakness is defined with regard to the compliance report and, therefore, applies only to a broker-dealer that files a compliance report

independent public accountant.⁷¹⁸ If the independent public accountant does not receive the notification within one business day, or if the independent public accountant does not agree with the statements in the notification, then the independent public accountant must notify the Commission and the DEA within one business day.⁷¹⁹ The report from the independent public accountant must, if the broker-dealer failed to file a notification, describe any instances of non-compliance that required a notification under Rule 15c3-1, Rule 15c3-3, or Rule 17a-11, or any material weaknesses.⁷²⁰ If the broker-dealer filed a notification, the report from the accountant must detail the aspects of the notification of the broker-dealer with which the accountant does not agree.⁷²¹

The Commission is proposing to amend paragraph (h) of Rule 17a-5 to add references to proposed Rule 18a-4 to the references to Rule 15c3-1, Rule 15c3-3, and Rule 17a-13.⁷²² Thus, the independent public accountant would need to notify the broker-dealer if the accountant determines the broker-dealer is not in compliance with proposed Rule 18a-4.⁷²³ Depending on the nature of the noncompliance, the broker-dealer may need to provide notification to the Commission in accordance with Rule 17a-11.⁷²⁴

⁷¹⁸ See 17 CFR 240.17a-5(h). See also 17 CFR 240.15c3-1(a)(6)(iv)(B), (a)(6)(v), (a)(7)(ii), (c)(2)(x)(C)(1), and (e); 17 CFR 240.15c3-1d(c)(2); 17 CFR 240.15c3-3(i); 17 CFR 240.17a-11. Notifications under Rule 17a-11 also must be filed with the CFTC if the broker-dealer is registered dually registered as a futures commission merchant with the CFTC. See 17 CFR 240.17a-11(g).

⁷¹⁹ See 17 CFR 240.17a-5(h).

⁷²⁰ See *id.*

⁷²¹ See *id.*

⁷²² See paragraph (h) of Rule 17a-5, as proposed to be amended.

⁷²³ See *id.*

⁷²⁴ See *id.* As discussed below in section II.C.2. of this release, the Commission is proposing to amend Rule 17a-11 to require notification to the Commission if a broker-dealer SBSB fails to make a required deposit into its reserve account under paragraph (c) of proposed Rule 18a-4.

The Commission is proposing to include parallel notification requirements in proposed Rule 18a-7 applicable to stand-alone SBSBs and stand-alone MSBSBs that are modeled on paragraph (h) of Rule 17a-5, as proposed to be amended.⁷²⁵ Because stand-alone SBSBs and stand-alone MSBSBs would be subject to different rules, paragraph (g) of proposed Rule 18a-7 would contain separate provisions for each type of registrant.⁷²⁶

Paragraph (g)(1) would apply to stand-alone SBSBs.⁷²⁷ Under this paragraph, the independent public accountant of a stand-alone SBSB would be required to notify the SBSB if the accountant determines that the SBSB is not in compliance with proposed Rules 18a-1, 18a-4, or 18a-9 or that any material weaknesses exist.⁷²⁸ Consequently, the independent public accountant would need to provide notice to a stand-alone SBSB regarding noncompliance with requirements that parallel the requirements for which an independent public accountant must provide notice to a broker-dealer under paragraph (h) of Rule 17a-5.⁷²⁹ Further, the independent public accountant would need to provide notice of a material weakness just as a broker-dealer's independent public accountant must provide notice of a material weakness.⁷³⁰ Like Rule 17a-5, the receipt by a stand-alone SBSB of a notice would trigger the requirement for the SBSB to

⁷²⁵ Compare paragraph (h) of Rule 17a-5, as proposed to be amended, with paragraph (g) of proposed Rule 18a-7.

⁷²⁶ See paragraphs (g)(1)-(2) of proposed Rule 18a-7.

⁷²⁷ See paragraph (g)(1) of proposed Rule 18a-7.

⁷²⁸ See *id.*

⁷²⁹ Compare 17 CFR 240.17a-5(h), with paragraph (g)(1) of proposed Rule 18a-7. As discussed above, proposed Rules 18a-1 and 18a-4 are modeled on Rules 15c3-1 and 15c3-3, respectively. Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70217-70257, 70274-70288. As discussed below in section II.C.2. of this release, proposed Rule 18a-8 is modeled on Rule 17a-11 (the broker-dealer notification rule). Stand-alone SBSBs would not be subject to an Account Statement Rule.

⁷³⁰ Compare 17 CFR 240.17a-5(h), with paragraph (g)(1) of proposed Rule 18a-7. As discussed above, the definition of the term material weakness in proposed Rule 18a-7 is modeled on the definition of the term material weakness in Rule 17a-5. Compare 17 CFR 240.17a-5(d)(3)(iii), with paragraph (c)(3)(iii) of proposed Rule 18a-7.

notify the Commission if the noncompliance requires notification under Rule 18a-8 or if the notice concerns a material weakness and to provide a copy of the notice to the accountant.⁷³¹

Further, the accountant would be required to notify the Commission if the accountant does not receive a copy of the notice or if the accountant disagrees with the notice.⁷³²

Paragraph (g)(2) of proposed Rule 18a-7 would apply to stand-alone MSBSPs.⁷³³

Because the Commission is not proposing that MSBSPs be subject to proposed Rule 18a-4, proposed Rule 18a-9, or the requirement to file a compliance report, the notification triggers in paragraph (g)(2) would be limited to noncompliance with the proposed Rule 18a-2 (the proposed tentative net worth standard for stand-alone MSBSPs).⁷³⁴ Like Rule 17a-5 and paragraph (g)(1) of proposed Rule 18a-7, the receipt by a stand-alone MSBSP of a notice of noncompliance with proposed Rule 18a-2 would trigger the requirement for the MSBSP to notify the Commission under Rule 18a-8 and to provide a copy of the notice to the independent public accountant.⁷³⁵ Further, the accountant would be required to notify the Commission if the accountant does not receive a copy of the notice or if the accountant disagrees with the notice.⁷³⁶

Reports of the Independent Public Accountant

Under the recent amendments to Rule 17a-5, Paragraph (i) of the rule prescribes requirements for the reports of the independent public accountant covering the broker-dealer's

⁷³¹ Compare 17 CFR 240.17a-5(h), with paragraph (g)(1) of proposed Rule 18a-7.

⁷³² See paragraph (g)(1) of proposed Rule 18a-7.

⁷³³ See paragraph (g)(2) of proposed Rule 18a-7.

⁷³⁴ See *id.* As discussed above, the concept of material weakness applies in the context of the filing of the compliance report and the report of the independent public accountant covering the compliance report.

⁷³⁵ See paragraph (g)(2) of proposed Rule 18a-7. As discussed below in section II.C.2. of this release, proposed Rule 18a-8 would require a stand-alone MSBSP to provide notice to the Commission if the firm receives notice of noncompliance with proposed Rule 18a-2 or determines that it is not in compliance with proposed Rule 18a-2.

⁷³⁶ See paragraph (g)(2) of proposed Rule 18a-7.

annual reports, including: (1) technical requirements;⁷³⁷ (2) required representations;⁷³⁸ (3) the opinions or conclusions to be expressed in the accountant's reports;⁷³⁹ and (4) requirements related to matters to which the accountant takes exception.⁷⁴⁰

As broker-dealers dually registered as SBSs or MSBSs, the independent public accountants of these registrants will need to prepare reports covering the registrant's financial report and compliance report pursuant to the requirements prescribed in paragraph (i) of Rule 17a-5.

The Commission is proposing to include parallel independent public accountant report requirements in proposed Rule 18a-7 applicable to stand-alone SBSs and stand-alone MSBSs that are modeled on paragraph (i) of Rule 17a-5.⁷⁴¹ Specifically, paragraph (h) of proposed Rule 18a-7 prescribes parallel requirements for the reports of the independent public accountant covering the stand-alone SBS's or stand-alone MSBS's annual reports, namely: (1) technical

⁷³⁷ See 17 CFR 240.17a-5(i)(1). Paragraph (i)(1) of Rule 17a-5 provides that the report of the independent public accountant must: (1) be dated; (2) be signed manually; (3) indicate the city and state where issued; and (iv) identify without detailed enumeration the items covered by the report. See *id.*

⁷³⁸ See 17 CFR 240.17a-5(i)(2). Paragraph (i)(2) provides that the report of the independent public accountant must: (1) state whether the examinations or review, as applicable, were made in accordance with standards of the PCAOB; and (2) identify any examination and, if applicable, review procedures deemed necessary by the independent public accountant under the circumstances of the particular case that have been omitted and the reason for their omission. See *id.* The paragraph further provides that nothing in Rule 17a-5 may be construed to imply authority for the omission of any procedure that independent public accountants would ordinarily employ in the course of an examination or review made for the purpose of expressing the opinions or conclusions required under Rule 17a-5. See *id.*

⁷³⁹ See 17 CFR 240.17a-5(i)(3). Paragraph (i)(3) provides that the report of the independent public accountant must state clearly: (1) the opinion of the independent public accountant with respect to the financial report and the accounting principles and practices reflected in that report; (2) the opinion of the independent public accountant with respect to the financial report as to the consistency of the application of the accounting principles, or as to any changes in those principles, that have a material effect on the financial statements; and (3)(i) the opinion of the independent public accountant with respect to certain statements in the compliance report; or (ii) the conclusion of the independent public accountant with respect to certain statements in the exemption report. See *id.*

⁷⁴⁰ See 17 CFR 240.17a-5(i)(4). Paragraph (i)(4) provides that any matters to which the independent public accountant takes exception must be clearly identified, the exceptions must be specifically and clearly stated, and, to the extent practicable, the effect of each such exception on any related items contained in the annual reports must be given.

⁷⁴¹ Compare 17 CFR 240.17a-5(i), with paragraph (h) of proposed Rule 18a-7.

requirements;⁷⁴² (2) required representations;⁷⁴³ (3) the opinions or conclusions to be expressed in the accountant's reports;⁷⁴⁴ and (4) requirements related to matters to which the accountant takes exception.⁷⁴⁵ The requirements in paragraph (h) of proposed Rule 18a-7 would not include the requirements relating to the review engagement with respect to the exemption report because, as discussed above, stand-alone SBSs and stand-alone MSBSs would not file exemption reports as part of their annual reports.⁷⁴⁶

Extensions and Exemptions

Paragraph (m) of Rule 17a-5 governs the granting of extensions of time to comply with the requirements of Rule 17a-5 and the granting of exemptions from complying with the requirements of the rule, and also provides two self-executing exemptions from complying with Rule 17a-5 for certain types of broker-dealers.⁷⁴⁷ As broker-dealers, dually registered SBSs or MSBSs will be able to seek extensions and exemptions under the provisions of paragraph (m).

The Commission is proposing to include a parallel extension and exemption provision in proposed Rule 18a-7 applicable to stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs that is modeled on paragraph (m) of Rule 17a-5, but that only provides that the

⁷⁴² Compare 17 CFR 240.17a-5(i)(1), with paragraph (h)(1) of proposed Rule 18a-7.

⁷⁴³ Compare 17 CFR 240.17a-5(i)(2), with paragraph (h)(2) of proposed Rule 18a-7.

⁷⁴⁴ Compare 17 CFR 240.17a-5(i)(3), with paragraph (h)(3) of proposed Rule 18a-7.

⁷⁴⁵ Compare 17 CFR 240.17a-5(i)(4), with paragraph (h)(4) of proposed Rule 18a-7.

⁷⁴⁶ See paragraph (h) of proposed Rule 18a-7.

⁷⁴⁷ See 17 CFR 240.17a-5(m). Paragraph (m)(1) of Rule 17a-5 provides that a broker-dealer's DEA may extend the period for filing the annual reports and requires the DEA to maintain a record of each granted extension. See 17 CFR 240.17a-5(m)(1). Paragraph (m)(2) exempts from the requirements of Rule 17a-5 entities that are: (1) banks or insurance companies as those terms defined in the Exchange Act; (2) are registered as broker-dealers to sell variable contracts; and (3) are exempt from Rule 15c3-1. See 17 CFR 240.17a-5(m)(2). Paragraph (m)(3) of Rule 17a-5 provides that the Commission may grant an extension of time or an exemption, upon written request of a national securities exchange, registered national securities association or the broker-dealer, from any of the requirements of Rule 17a-5 either unconditionally or on specified terms and conditions. See 17 CFR 240.17a-5(m)(3). Paragraph (m)(4) of Rule 17a-5 exempts from the requirements of Rule 17a-5 entities registered as broker-dealers under section 15(b)(1)(A) of the Exchange Act the purpose of effecting transactions in security futures products. See 17 CFR 240.17a-5(m)(4).

Commission may grant extensions or exemptions.⁷⁴⁸ Specifically, paragraph (i) of proposed Rule 18a-7 would provide that upon written application by a stand-alone SBSB or stand-alone MSBSP to the Commission or on its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of proposed Rule 18a-7 either unconditionally or on specified terms and conditions.⁷⁴⁹

Notification of change of fiscal year

Paragraph (n)(1) of Rule 17a-5 requires a broker-dealer to notify the Commission and its DEA of a change of its fiscal year.⁷⁵⁰ Paragraph (n)(2) requires that the notice contain a detailed explanation for the reasons for the change and requires that changes in the filing period for the annual reports must be approved in writing by the broker-dealer's DEA.⁷⁵¹ As broker-dealers, dually registered broker-dealer SBSBs and broker-dealer MSBSPs will be required to file the notices of changes in fiscal years and obtain approvals from their DEAs as prescribed in paragraph (n).

The Commission is proposing to include a parallel change in fiscal year requirement in proposed Rule 18a-7 applicable to stand-alone SBSBs and stand-alone MSBSPs that is modeled on paragraph (n) of Rule 17a-5, but that only provides that the Commission may approve a

⁷⁴⁸ Compare 17 CFR 240.17a-5(m), with paragraph (i) of proposed Rule 18a-7. As discussed above in section II.B.2. of this release, bank SBSBs and bank MSBSPs would be required to file proposed Form SBS on a quarterly basis. These types of registrants would be able to use the provisions of paragraph (i) of proposed Rule 18a-7 to seek extensions and exemptions from the provisions of the rule relating to the filing of proposed Form SBS.

⁷⁴⁹ See paragraph (i) of proposed Rule 18a-7. Paragraph (i) of proposed Rule 18a-7 does not include the self-executing exemption in paragraph (m)(2) of Rule 17a-5 (applicable to banks and insurance companies registered as broker-dealers to sell variable contracts) and in paragraph (m)(4) of Rule 17a-5 (applicable to broker-dealers only effecting transactions in security futures products). Stand-alone SBSBs and stand-alone MSBSPs would not qualify for these exemptions because, among other things, they would engage in a broader range of activities than those permitted of entities that may use the exemptions.

⁷⁵⁰ See 17 CFR 240.17a-5(n)(1).

⁷⁵¹ See 17 CFR 240.17a-5(n)(2).

change in the filing period for the annual reports.⁷⁵² Specifically, paragraph (j)(1) of proposed Rule 18a-7 would provide that, in the event any stand-alone SBSD or stand-alone MSBSP finds it necessary to change its fiscal year, it must file, with the Commission's principal office in Washington, DC and the regional office of the Commission for the region in which the SBSD or MSBSP has its principal place of business, a notice of such change.⁷⁵³ Paragraph (j)(2) would provide that the notice must contain a detailed explanation of the reasons for the change and that any change in the filing period for the annual reports must be approved in writing by the Commission.⁷⁵⁴

Filing Requirements

Paragraph (o) of Rule 17a-5 provides that a filing pursuant to the rule is deemed to be accomplished when it is received by the Commission's principal office with duplicates filed simultaneously at the locations prescribed in other parts of Rule 17a-5.⁷⁵⁵ As broker-dealers, dually registered broker-dealer SBSDs and broker-dealer MSBSPs will be required to comply with the filing requirements prescribed in paragraph (o).

The Commission is proposing to include a parallel filing requirement in proposed Rule 18a-7 applicable to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs that mirrors paragraph (o) of Rule 17a-5.⁷⁵⁶ Specifically, paragraph (k) of proposed Rule 18a-7 would provide that for purposes of the filing requirements in the rule, filing will be deemed to have been accomplished upon receipt at the Commission's principal office in Washington, DC,

⁷⁵² Compare 17 CFR 240.17a-5(n), with paragraph (j) of proposed Rule 18a-7.

⁷⁵³ See paragraph (j)(1) of proposed Rule 18a-7.

⁷⁵⁴ See paragraph (j)(2) of proposed Rule 18a-7.

⁷⁵⁵ See 17 CFR 240.17a-5(o).

⁷⁵⁶ Compare 17 CFR 240.17a-5(o), with paragraph (k) of proposed Rule 18a-7.

with duplicate originals simultaneously filed at the locations prescribed in the particular paragraph of the rule which is applicable.⁷⁵⁷

Request for Comment

The Commission generally requests comment on the proposed amendments to Rule 17a-5 and proposed Rule 18a-7. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Will the majority of stand-alone SBSDs apply to use internal models to calculate net capital? If not, what portion of stand-alone SBSDs will apply to use internal models?
2. Paragraph (j)(2) of proposed Rule 18a-7 would require the Commission to approve a change in the fiscal year of a stand-alone SBSD or stand-alone MSBSP. Should the rule instead provide that a stand-alone SBSD or stand-alone MSBSP may provide notice to the Commission of a change in fiscal year and that the notice will be deemed approved by the Commission unless the Commission rejects the change within a prescribed period of time such as 30, 60, or 90 days? Are there any other alternative approval mechanisms the Commission should consider?
3. Under the recently adopted amendments to Rule 17a-5, paragraphs (f)(2)(ii)(F) and (G) require each clearing broker-dealer to include a representation in its statement regarding its independent public accountant that the broker-dealer agrees to allow Commission and DEA examination staff to review the audit documentation associated with its annual audit reports required under Rule 17a-5 and to allow its independent public accountant to discuss findings relating to the audit reports with Commission and DEA examination

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See paragraph (k) of proposed Rule 18a-7.

staff if requested for the purposes of an examination of the broker-dealer. Should this requirement apply to stand-alone SBSBs? Explain why or why not.

4. Will entities already registered with the Commission as investment advisers, but not as broker-dealers, also register with the Commission as SBSBs? If so, would the compliance report and the independent public accountant's report based on an examination of the compliance report be sufficient to satisfy the requirement that certain investment advisers obtain an internal control report pursuant to Rule 206(4)-2 under the Investment Advisers Act of 1940?
5. Could there be broker-dealer SBSBs that claim an exemption from Rule 15c3-3, but that would be subject to Rule 18a-4? Please provide data to support the answer. If there would be a broker-dealer SBSB that claims an exemption from Rule 15c3-3 but would be subject to Rule 18a-4, should the firm submit an exemption report under paragraph (d)(1)(i)(B)(2) relating to its exemption from Rule 15c3-3 and also submit a compliance report under paragraph (d)(1)(i)(B)(1) of Rule 17a-5 relating to its compliance with Rule 18a-4? Please explain why or why not.
6. Paragraph (b)(1) of proposed Rule 18a-7 would require each nonbank stand-alone SBSB and nonbank stand-alone MSBSP to make certain documents publicly available on its website within ten business days after the date the firm is required to file its annual reports with the Commission. Should firms be given more or less time than ten business days to post the requisite documents on their websites? Explain why or why not.
7. Paragraph (b)(2) of proposed Rule 18a-7 would require each nonbank stand-alone SBSB and nonbank stand-alone MSBSP to make publicly available on its website unaudited statements as of the date that is six months after the date of the most recent audited

statements filed with the Commission. These reports would need to be made publicly available within thirty calendar days of the date of the statements. Should firms be given more or less time than thirty calendar days to post their unaudited financial statements on their websites? Explain why or why not.

b. Additional Proposed Amendments to Rule 17a-5

The Commission is proposing several amendments to Rule 17a-5 to eliminate obsolete text, improve readability, and modernize terminology. The Commission is proposing a global change that would replace the use of the word “shall” in the rule with the word “must” or “will” where appropriate.⁷⁵⁸ The Commission also proposes to make certain stylistic, corrective, and punctuation amendments to improve Rule 17a-5’s readability.⁷⁵⁹

As a consequence of the proposed deletion of current paragraph (a)(1) of Rule 17a-5, paragraphs (a)(2)(i), (a)(2)(ii), and (a)(2)(iii) would be redesignated paragraphs (a)(1)(i), (a)(1)(ii), and (a)(1)(iii), respectively (and the cross-references to these paragraphs would also be

⁷⁵⁸ The proposed amendments would replace the word “shall” with the word “must” or “will” in the following paragraphs of Rule 17a-5, as proposed to be amended: (a)(1)(v), (a)(2), (a)(3), (a)(6), (b)(1), (b)(3), (b)(4), (b)(5), (c)(1), (c)(2), (c)(2)(i), (c)(2)(ii), (c)(3), (c)(4)(iii), (e)(3), note to paragraph (h), (k), (l), (m)(1), (m)(2), (m)(4), (n)(2), and (o). See Rule 17a-5, as proposed to be amended.

⁷⁵⁹ The Commission proposes the following stylistic and corrective changes to Rule 17a-5, as proposed to be amended: (1) clarifying in paragraph (a)(5) that ANC broker-dealers must file additional reports “with the Commission”; (2) replacing “monthly” with “on a monthly basis” in paragraph (a)(1)(v); (3) replacing “10 largest commitments” with “ten largest commitments” in paragraph (a)(5)(v)(C); (4) replacing “broker or dealer’s” with “broker’s or dealer’s” in paragraphs (a)(5)(v)(D)-(G); (5) cross-referencing “paragraphs (c)(1) and (c)(2)” and “paragraphs (c)(2)(i) and (c)(2)(ii)” instead of “paragraphs (c)(1) and (2)” and “paragraphs (c)(2)(i) and (ii)” in paragraph (c)(3); (6) cross-referencing “paragraphs (c)(2)(iii) and (c)(2)(iv)” instead of “paragraphs (c)(2)(iii) and (iv)” in paragraph (c)(5)(i)(C); (7) eliminating the quotation marks around the defined term “customer” in paragraph (c)(4), and instead italicizing the defined term if it is not already italicized; (7) replacing the phrase “Home page” with the phrase “home page” in paragraph (c)(5)(iii)(C); (8) referring to a broker-dealer’s annual report in the singular instead of the plural in paragraph (e)(1)(ii) by replacing the phrase “annual reports”, and the words “are”, and “reports” with the phrase “an annual report”, the word “is”, and the phrase “a report”, respectively; (9) adding the word “the” before the phrase “independent public accountant does not agree” in paragraph (f)(3)(v)(B); (10) removing the phrase “by telegram” in the last sentence of the Note to paragraph (h); (11) adding the word “Reserved” in brackets in paragraph (j); (12) replacing the phrase “Division of Market Regulation” with the phrase “Division of Trading and Markets” in paragraph (k); (13) replacing the phrase “Securities Exchange Act of 1934” with the word “Act” in paragraph (l); (14) removing the U.S.C. citations from paragraphs (m)(2) and (m)(4), since the rule already cites to the applicable section of the Exchange Act; and (15) replacing the phrase “§ 240.17a-5” with the phrase “this section” in paragraph (o).

updated accordingly). Further, as discussed above, the Commission is proposing to add a new paragraph (a)(1)(iv) to Rule 17a-5. As a consequence of the proposed deletion of paragraph (a)(1) and addition of paragraph (a)(1)(iv), paragraph (a)(2)(iv) would be redesignated paragraph (a)(1)(v). Further, as a consequence of the deletion of paragraph (a)(1), paragraphs (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7) of Rule 17a-5 would be redesignated paragraphs (a)(2), (a)(3), (a)(4), (a)(5), and (a)(6), respectively (and the cross-references to these paragraphs would also be updated accordingly).

The Commission is proposing to amend paragraph (a)(4) of Rule 17a-5 to specify that a DEA “must promptly transmit that information” obtained through the filing of Form Custody, instead of merely requiring that the DEA “transmit the information” obtained through the Form Custody filing. Pursuant to this amendment, the DEA must provide this information promptly to the Commission after it is obtained from the broker-dealers, which would facilitate the Commission’s monitoring of broker-dealer custody practices.

Instead of grouping the ANC reports required by paragraph (a)(5) by the applicable timeframe, the Commission is proposing to specify the applicable timeframe in each paragraph requiring an ANC report to be filed. As a result, the numbering within paragraph (a)(5) of Rule 17a-5, as proposed to be amended, would be largely restructured due to the consolidation of paragraph (a)(5)(i)(A) into paragraph (a)(5)(i), and due to the elimination of certain sublevels to improve the paragraph’s organization.

As discussed above, the Commission is proposing to add to paragraph (e)(2) of Rule 17a-5 a reference to Part III of Form X-17A-5, which contains the required oath or affirmation. Thus, the Commission does not believe it is necessary to identify the content of the oath or affirmation, and proposes to remove the required text of the oath or affirmation in the rule text.

The Commission also proposes to add clarity by specifying that the oath or affirmation is “made in Part III of Form X-17A-5”.

Since the recently adopted amendments to Rule 17a-5 require a more diverse range of annual filings, the Commission is proposing to amend paragraph (e)(2) of Rule 17a-5 to reference “the annual reports” instead of “the financial report”.

Reference is made in paragraph (e)(3) to a “member” of a national securities exchange as a distinct class of registrant in addition to a “broker” and “dealer”. The Commission is proposing to remove this reference to a “member” given that the rule applies to brokers-dealers, which would include a member of a national securities exchange that is a broker-dealer.

Request for Comment

The Commission generally requests comment on these additional proposed amendments to Rule 17a-5, including comment on whether any of the proposed amendments would result in substantive changes to the requirements applicable to broker-dealers.

C. Notification

1. Introduction

As discussed above, section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.⁷⁶⁰ Section 15F(f)(2) provides that the Commission shall adopt rules governing reporting for SBSDs and MSBSPs.⁷⁶¹ Further, section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.⁷⁶² In

⁷⁶⁰ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10.

⁷⁶¹ See 15 U.S.C. 78o-10(f)(2).

⁷⁶² See 15 U.S.C. 78o-10(f)(1)(A).

addition, the Commission also has concurrent authority under section 17(a)(1) of the Exchange Act to prescribe reporting requirements for broker-dealers.⁷⁶³

After considering the anticipated business activities of SBSDs and MSBSPs, the Commission is proposing to establish a notification program for these registrants under sections 15F(f) and 17(a) of the Exchange Act that is modeled on the notification program for broker-dealers codified in Rule 17a-11.⁷⁶⁴ Rule 17a-11 specifies the circumstances under which a broker-dealer must notify the Commission and other regulators about its financial or operational condition, as well as the form that the notice must take.⁷⁶⁵

Rule 17a-11 was promulgated in the aftermath of the securities industry “paper work crisis” of 1967-1970.⁷⁶⁶ This crisis prompted the Commission to undertake a study of unsafe and unsound practices of brokers and dealers.⁷⁶⁷ The study found, among other things, that early warning signals required of broker-dealers at the time were inadequate to foretell financial and operational difficulties in a reliable and timely manner.⁷⁶⁸ This diminished the Commission’s ability to take effective proactive steps to respond when a broker-dealer was experiencing or was likely to experience financial difficulty.⁷⁶⁹ In response, the Commission adopted Rule 17a-11.⁷⁷⁰

⁷⁶³ See 15 U.S.C. 78q(a)(1).

⁷⁶⁴ See 17 CFR 240.17a-11. As discussed below, the Commission also is proposing a parallel notification requirement applicable to stand-alone SBSDs that is modeled on a broker-dealer notification requirement in paragraph (i) of Rule 15c3-3. See 17 CFR 240.15c3-3(i).

⁷⁶⁵ See 17 CFR 240.17a-11.

⁷⁶⁶ See Study of Unsafe and Unsound Practices of Brokers and Dealers.

⁷⁶⁷ See id.

⁷⁶⁸ See id. at 2.

⁷⁶⁹ See id. at 12.

⁷⁷⁰ See Prompt Notice of Net Capital or Recordkeeping Violations, 36 FR 14725. See also Prompt Notice of Net Capital or Record Keeping Violations, Exchange Act Release No. 9128 (Apr. 20, 1971), 36 FR 7972 (Apr. 28, 1971) (proposing Rule 17a-11) (“Experience during the past 3 years has demonstrated that neither the Commission nor any self-regulatory body is receiving an adequate and timely flow of information on

This rule requires a broker-dealer to notify the Commission when, among other things, its net capital falls below 120% of the minimum required amount or below the minimum required amount, or when the firm fails to make and keep current the books and records required by Commission rules.⁷⁷¹

The Commission is proposing to establish notification requirements applicable to SBSDs and MSBSPs in order to require the timely notification to the Commission of information about potential problems at these registrants. The Commission would use the notifications to respond, when necessary, to financial or operational problems at a particular SBSD or MSBSP by, for example, heightening its supervision of the firm.

Under the proposed notification program for SBSDs and MSBSPs, broker-dealer SBSDs and broker-dealer MSBSPs – as broker-dealers – would be subject to Rule 17a-11.⁷⁷² The Commission is proposing amendments to this rule to account for a broker-dealer that is dually registered as an SBSD or MSBSP. Stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be subject to proposed Rule 18a-8, which is modeled on Rule 17a-11, as proposed to be amended. Proposed Rule 18a-8 would not include a parallel requirement for every requirement in Rule 17a-11.⁷⁷³

the financial and operational condition of broker-dealers. Accordingly, there is a need for a Commission rule which would impose upon firms (and, secondarily, upon the self-regulatory bodies themselves) a duty to report net capital and operational problems.”).

⁷⁷¹ See 17 CFR 240.17a-11.

⁷⁷² See *id.*

⁷⁷³ The Commission is not proposing to include in proposed Rule 18a-8 notice requirements that would parallel the notice requirements in paragraphs (c)(1) and (2) of Rule 17a-11 because these requirements relate to ratios in Rule 15c3-1 (the capital rule for broker-dealers) that are not incorporated into proposed Rule 18a-1 (the proposed capital standard for stand-alone SBSDs) or proposed Rule 18a-2 (the proposed capital standard for stand-alone MSBSPs). The Commission is not proposing to include in proposed Rule 18a-8 a notice requirement that would parallel the notice requirement in paragraph (f) of Rule 17a-11 because this requirement generally arises in the context of an Exchange’s supervision of a broker-dealer as an SRO of the firm. The Commission is not proposing to include in proposed Rule 18a-8 a provision that would parallel the provision in paragraph (h) of Rule 17a-11 because this provision cross-references notice requirements in other Commission rules that would not apply to a stand-alone SBSD or stand-alone

For the reasons discussed above in section I. of this release, the proposed notification requirements for bank SBSDs and bank MSBSPs are substantially narrower in scope than the notification requirements for broker-dealer SBSDs, broker-dealer MSBSPs, stand-alone SBSDs, and stand-alone MSBSPs. Moreover, the proposed notification requirements applicable to bank SBSDs and bank MSBSPs, in one case, parallel a notification requirement the prudential regulators have established for banks.⁷⁷⁴ Thus, bank SBSDs and bank MSBSPs would be able to use the same information reported to the prudential regulators to comply with the proposed requirement.

2. Amendments to Rule 17a-11 and Proposed Rule 18a-8

Undesignated Introductory Paragraph

Rule 17a-11, as proposed to be amended, would contain an undesignated introductory paragraph explaining that the rule applies to a broker-dealer, including a broker-dealer dually registered with the Commission as an SBSD or MSBSP.⁷⁷⁵ The note further explains that an SBSD or MSBSP that is not dually registered as a broker-dealer (i.e., a stand-alone SBSD, stand-alone MSBSP, bank SBSD, or bank MSBSP) is subject to the notification requirements under proposed Rule 18a-8.⁷⁷⁶ Further, the Commission is proposing to delete paragraph (a) of Rule 17a-11, which provides that the rule shall apply to every broker-dealer registered pursuant to

MSBSP. Finally, the Commission is not proposing to include in proposed Rule 18a-8 a provision that would parallel the provision in paragraph (i) of Rule 17a-11 because this provision establishes an exemption for a special class of broker-dealer.

⁷⁷⁴ See paragraph (c) of proposed Rule 18a-8.

⁷⁷⁵ See undesignated introductory paragraph of Rule 17a-11, as proposed to be amended.

⁷⁷⁶ See id.

section 15 of the Exchange Act.⁷⁷⁷ This text would be redundant, given the proposed undesignated introductory paragraph of Rule 17a-5.⁷⁷⁸

Similarly, proposed Rule 18a-8 would contain an undesignated introductory paragraph explaining that the rule applies to an SBSD or an MSBSP that is not registered as a broker-dealer.⁷⁷⁹ The note further explains that a broker-dealer that is dually registered as an SBSD or MSBSP is subject to the notification requirements under Rule 17a-11.⁷⁸⁰

Failure to Meet Minimum Capital Requirements

Paragraph (b) of Rule 17a-11 requires a broker-dealer to notify the Commission if the firm's net capital or, if applicable, tentative net capital declines below the minimum amount required under Rule 15c3-1.⁷⁸¹ Specifically, paragraph (b)(1) requires notification to the Commission when a broker-dealer's net capital falls below the required level the same day it discovers or is notified by the Commission or its DEA of the net capital deficiency.⁷⁸² If the broker-dealer disagrees with the Commission or the DEA that a net capital deficiency exists, the firm can indicate in the notice the reasons for disagreeing. Paragraph (b)(2) of Rule 17a-11

⁷⁷⁷ See 17 CFR 240.17a-11(a). As a consequence of this deletion, paragraphs (b), (c), (d), and (e) of Rule 17a-11 would be redesignated paragraphs (a), (b), (c), and (d), respectively. Further, as discussed below, the Commission is proposing to add two new notification provisions to Rule 17a-11 that would be codified in paragraphs (e) and (f) of the rule, as proposed to be amended. As a consequence of the deletion of paragraph (a) and addition of the two new provisions, paragraphs (f), (g), (h), and (i) would be redesignated paragraphs (g), (h), (i), and (j), respectively.

⁷⁷⁸ See undesignated introductory paragraph of Rule 17a-11, as proposed to be amended.

⁷⁷⁹ See undesignated introductory paragraph of proposed Rule 18a-8.

⁷⁸⁰ See *id.*

⁷⁸¹ See 17 CFR 240.17a-11(b).

⁷⁸² See 17 CFR 240.17a-11(b)(1). Rule 15c3-1 requires broker-dealers to maintain a minimum level of net capital (meaning highly liquid capital) at all times. See 17 CFR 240.15c3-1. The rule requires that a broker-dealer perform two calculations: (1) a computation of the minimum amount of net capital the broker-dealer must maintain; and (2) a computation of the amount of net capital the broker-dealer is maintaining. See 17 CFR 240.15c3-1(a) and (c)(2). As discussed above in sections II.A. and II.B.2.b. of this release, the minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of aggregate debit items ratio. See 17 CFR 240.15c3-1(a).

requires an OTC derivatives dealer or an ANC broker-dealer to also notify the Commission when its tentative net capital falls below the minimum required for these types of broker-dealers.⁷⁸³ In either case, the notice must specify the broker-dealer's net capital or tentative net capital requirement and its current amount of net capital or tentative net capital.⁷⁸⁴ As broker-dealers, dually registered SBSDs and MSBSPs will be required to comply with the existing notification requirements.

The Commission is proposing to include parallel capital deficiency notification requirements in proposed Rule 18a-8 applicable to stand-alone SBSDs and stand-alone MSBSPs that are modeled on the requirements in paragraph (b) of Rule 17a-5.⁷⁸⁵ Specifically, paragraph (a)(1)(i) of proposed Rule 18a-8 would require a stand-alone SBSD to give notice to the Commission on the same day if the firm's net capital declines below the minimum amount required pursuant to proposed Rule 18a-1 or if the Commission informs the stand-alone SBSD that it is or has been in violation of proposed Rule 18a-1.⁷⁸⁶ The notice would need to specify the stand-alone SBSD's net capital requirement and its current amount of net capital.⁷⁸⁷ Further, if the notice is triggered by the Commission informing the stand-alone SBSD that it is or has

⁷⁸³ See 17 CFR 240.17a-11(b)(2).

⁷⁸⁴ See 17 CFR 240.17a-11(b)(1) and (2). As discussed above, paragraph (b) of Rule 17a-11 would be redesignated paragraph (a). Further, as discussed below in section II.C.3. of this release, the Commission is proposing certain technical amendments to the text in paragraph (b), which would be contained in paragraph (a) of Rule 17a-11, as proposed to be amended.

⁷⁸⁵ Compare 17 CFR 240.17a-11(b), with paragraph (a) of proposed Rule 18a-8.

⁷⁸⁶ See paragraph (a)(1)(i) of proposed Rule 18a-8. Proposed Rule 18a-1 – which is modeled on Rule 15c3-1 – would specify minimum net capital requirements for stand-alone SBSDs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70221–70230.

⁷⁸⁷ See paragraph (a)(1)(i) of proposed Rule 18a-8.

been in violation of proposed Rule 18a-1 and the SBSB disagrees, the SBSB could specify the reasons for the disagreement in the notice.⁷⁸⁸

Paragraph (a)(1)(ii) of proposed Rule 18a-8 would require a stand-alone ANC SBSB to give notice to the Commission on the same day if its tentative net capital declines below the minimum amount required pursuant to proposed Rule 18a-1 or if the Commission informs the stand-alone ANC SBSB that it is or has been in violation of proposed Rule 18a-1.⁷⁸⁹ The notice would need to specify the stand-alone ANC SBSB's tentative net capital requirement and its current amount of tentative net capital.⁷⁹⁰ Further, if the notice is triggered by the Commission informing the stand-alone ANC SBSB that it is or has been in violation of proposed Rule 18a-1 and the SBSB disagrees, the SBSB could specify the reasons for the disagreement in the notice.⁷⁹¹

Paragraph (a)(2) of proposed Rule 18a-8 would require a stand-alone MSBSP to give notice to the Commission on the same day if it fails to maintain a positive tangible net worth pursuant to proposed Rule 18a-2 or if the Commission informs the stand-alone MSBSP that it is or has been in violation of proposed Rule 18a-2.⁷⁹² The notice would need to specify the extent to which the firm has failed to maintain positive tangible net worth. Further, if the notice is

⁷⁸⁸ See *id.*

⁷⁸⁹ See paragraph (a)(1)(ii) of proposed Rule 18a-8. Proposed Rule 18a-1 would specify minimum tentative net capital requirements for stand-alone ANC SBSBs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70226–70227.

⁷⁹⁰ See paragraph (a)(1)(ii) of proposed Rule 18a-8.

⁷⁹¹ See *id.*

⁷⁹² See paragraph (a)(2) of proposed Rule 18a-8. Proposed Rule 18a-2 would require stand-alone MSBSPs to maintain positive tangible net worth. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70256–70257. Under proposed Rule 18a-2, tangible net worth would be defined to mean the stand-alone MSBSP's net worth as determined in accordance with generally accepted accounting principles in the U.S., excluding goodwill and other intangible assets. See *id.*

triggered by the Commission informing the stand-alone MSBSP that it is or has been in violation of proposed Rule 18a-2 and the MSBSP disagrees, the MSBSP could specify the reasons for the disagreement in the notice.

Early Warning of Potential Capital or Model Problem

Paragraph (c) of Rule 17a-11 specifies four events that, if they occur, trigger a requirement that a broker-dealer send notice promptly (but within twenty-four hours) to the Commission.⁷⁹³ These notices are designed to provide the Commission with “early warning” that the broker-dealer may experience financial difficulty. The events triggering the early warning notification requirements are:

- The computation of a broker-dealer subject to the aggregate indebtedness standard of Rule 15c3-1 shows that its aggregate indebtedness is in excess of 1,200% of its net capital;⁷⁹⁴
- The computation of a broker-dealer which has elected to use the alternative standard of calculating net capital under Rule 15c3-1 shows that the firm’s net capital is less than 5% of aggregate debit items computed in accordance with Appendix A of Rule 15c3-3;⁷⁹⁵
- A broker-dealer’s net capital computation shows that its total net capital is less than 120% of its required minimum level of net capital or of its required minimum level of tentative net capital, in the case of an OTC derivatives dealer;⁷⁹⁶
- With respect to an OTC derivatives dealer, the occurrence of the fourth and each subsequent backtesting exception under Appendix F of Rule 15c3-1 during any 250 business day measurement period.⁷⁹⁷

⁷⁹³ See 17 CFR 240.17a-11(c).

⁷⁹⁴ See 17 CFR 240.17a-11(c)(1). As discussed above, the minimum net capital requirement for certain types of broker-dealers is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying a 15-to-1 aggregate indebtedness to net capital ratio. See 17 CFR 240.15c3-1(a)(1)(i). Consequently, requiring notification when a broker-dealer has a 12-to-1 aggregate indebtedness to net capital ratio provides notice before the firm reaches the minimum 15-to-1 requirement.

⁷⁹⁵ See 17 CFR 240.17a-11(c)(2). As discussed above, the minimum net capital requirement for certain types of broker-dealers is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying a 2% of aggregate debit items ratio. See 17 CFR 240.15c3-1(a)(1)(ii). Consequently, requiring notification when a broker-dealer has net capital equal to 5% of aggregate debit items provides notice before the firm reaches the 2% minimum requirement.

⁷⁹⁶ See 17 CFR 240.17a-11(c)(3).

As broker-dealers, dually registered SBSDs and MSBSPs will be required to comply with the existing notification requirements.⁷⁹⁸ The Commission is proposing to add a new notification requirement in paragraph (c) applicable to broker-dealer MSBSPs. Specifically, paragraph (c)(5) of Rule 17a-3, as proposed to be amended, would require a broker-dealer MSBSP to notify the Commission when its level of tangible net worth falls below \$20 million.⁷⁹⁹

The Commission also is proposing to include parallel early warning notification requirements in proposed Rule 18a-8 applicable to stand-alone SBSDs and stand-alone MSBSPs that are modeled on the requirements in paragraph (c) of Rule 17a-5.⁸⁰⁰ Specifically, paragraph

⁷⁹⁷ See 17 CFR 240.17a-11(c)(4). OTC derivatives dealers (and ANC broker-dealers) take market risk charges when computing net capital that are determined using the VaR models instead of applying standardized haircuts. The amount of the VaR measure computed by the model must be multiplied by a factor of at least three but potentially a greater factor based on the number of exceptions to the measure resulting from quarterly backtesting exercises. A backtesting exception occurs when the ANC broker-dealer's actual one-day loss exceeds the amount estimated by its VaR model. Multiple backtesting exceptions can indicate a problem with the VaR model. See, e.g., Basel Committee on Banking Supervision, Supervisory framework for the use of "backtesting" in conjunction with the internal models approach to market risk capital requirements (Jan. 1996), available at <http://www.bis.org/publ/bcbs22.pdf> ("The essence of all backtesting efforts is the comparison of actual trading results with model-generated risk measures. If this comparison is close enough, the backtest raises no issues regarding the quality of the risk measurement model. In some cases, however, the comparison uncovers sufficient differences that problems almost certainly must exist, either with the model or with the assumptions of the backtest. In between these two cases is a grey area where the test results are, on their own, inconclusive.").

⁷⁹⁸ As discussed above, paragraph (c) of Rule 17a-11 would be redesignated paragraph (b). Further, as discussed below in section II.C.3. of this release, the Commission is proposing certain largely technical amendments to the text in paragraph (c), which would be contained in paragraph (b) of Rule 17a-5, as proposed to be amended.

⁷⁹⁹ See paragraph (b)(6) of Rule 17a-11, as proposed to be amended. As discussed above, proposed Rule 18a-2 would require nonbank MSBSP to maintain a positive tangible net equity. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70256–70257. The Commission, however, did not propose that a nonbank MSBSP be required to a minimum amount of positive net equity. See *id.* The CFTC proposed a \$20 million fixed-dollar "tangible net equity" minimum requirement for swap dealers and major swap participants that are not FCMs and are not affiliated with a U.S. bank holding company. See Capital Requirements of Swap Dealers and Major Swap Participants, 78 FR at 27827. Further, OTC derivatives dealers are required to maintain minimum net capital of \$20 million. See 17 CFR 240.15c3-1(a)(5). In addition, the Commission has proposed a \$20 million fixed-dollar minimum net capital requirement for stand-alone SBSDs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70221–70227. The proposed \$20 million early warning threshold for broker-dealer MSBSPs is based on these proposals and requirements.

⁸⁰⁰ Compare 17 CFR 240.17a-11(c), with paragraph (b) of proposed Rule 18a-8.

(b)(1) of proposed Rule 18a-8 would require a stand-alone SBSD to notify the Commission promptly (but within twenty-four hours) when the SBSD's net capital falls below 120% of the SBSD's required minimum tentative net capital.⁸⁰¹ Paragraph (b)(2) of proposed Rule 18a-8 would require a stand-alone ANC SBSD to notify the Commission when the SBSD's tentative net capital falls below 120% of the SBSD's required minimum net capital.⁸⁰² Paragraph (b)(3) of proposed Rule 18a-8 would require a stand-alone MSBSP to notify the Commission when its level of tangible net worth falls below \$20 million.⁸⁰³ Finally, paragraph (b)(4) of proposed Rule 18a-8 would require a stand-alone ANC SBSD to report the occurrence of the fourth and any subsequent backtesting exception performed pursuant to paragraph (d) of Rule 18a-1 during any 250 business day measurement period.⁸⁰⁴

Notice of Adjustment of Reported Capital Category

Prudential regulators have established five capital categories that are used to describe a bank's capital strength: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.⁸⁰⁵ The definition of each capital category is based on capital measures under the bank capital standard and other factors.⁸⁰⁶ A bank is required to notify its appropriate prudential regulator of adjustments to the bank's capital category that may have occurred that would put the bank into a lower capital category from the category previously assigned to it. Following the notice, the prudential regulator determines

⁸⁰¹ See paragraph (b)(1) of proposed Rule 18a-8.

⁸⁰² See paragraph (b)(2) of proposed Rule 18a-8.

⁸⁰³ See paragraph (b)(3) of proposed Rule 18a-8.

⁸⁰⁴ See paragraph (b)(4) of proposed Rule 18a-8.

⁸⁰⁵ See 12 CFR 325.103; 12 CFR 6.4; 12 CFR 208.43.

⁸⁰⁶ See *id.*

whether the bank needs to adjust its capital category.⁸⁰⁷ Because these notices may indicate that a bank is in or approaching financial difficulty, the Commission is proposing to include a notification requirement in proposed Rule 18a-8 that would require a bank SBSD or a bank MSBSP to give notice to the Commission when it files an adjustment of reported capital category with its prudential regulator by transmitting a copy of the notice to the Commission.⁸⁰⁸

Failure to Make and Keep Current Books and Records

Paragraph (d) of Rule 17a-11 requires a broker-dealer that fails to make and keep current the books and records required under Rule 17a-3 to notify the Commission of this fact on the same day that the failure arises.⁸⁰⁹ The notice must specify the books and records which have not been made or which are not current.⁸¹⁰ In addition, a broker-dealer is required to report to the Commission within forty-eight hours of the original notice a report stating what the broker or dealer has done or is doing to correct the situation.⁸¹¹ As broker-dealers, dually registered SBSDs and MSBSPs will be required to comply with the existing notification requirements in paragraph (d).⁸¹²

The Commission is proposing to include a parallel books and records notification requirement in proposed Rule 18a-7 applicable to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs that is modeled on the requirement in paragraph (d) of Rule

⁸⁰⁷ See 12 CFR 6.3(c); 12 CFR 208.42(c); 12 CFR 325.102(c).

⁸⁰⁸ See paragraph (b) of proposed Rule 18a-8.

⁸⁰⁹ See 17 CFR 240.17a-11(d).

⁸¹⁰ See *id.*

⁸¹¹ See *id.*

⁸¹² As discussed above, paragraph (d) of Rule 17a-11 would be redesignated paragraph (c). Further, as discussed below in section II.C.3. of this release, the Commission is proposing certain technical amendments to the text in paragraph (d), which would be contained in paragraph (c) of Rule 17a-5, as proposed to be amended.

17a-5.⁸¹³ Specifically, paragraph (d) of proposed Rule 18a-8 would require a stand-alone SBSB, stand-alone MSBSP, bank SBSB, or bank MSBSP that fails to make and keep current the books and records required under proposed Rule 18a-5 to give notice of this fact that same day and specify in the notice the books and records which have not been made or which are not current.⁸¹⁴ Further, these registrants would be required to transmit a report within 48 hours of the notice stating what the registrant has done or is doing to correct the situation.⁸¹⁵

Material Weakness

The recently adopted amendments to paragraph (e) of Rule 17a-11 require a broker-dealer to provide notification about a material weakness as that term is defined in Rule 17a-5.⁸¹⁶ Specifically, paragraph (e) provides that, whenever a broker-dealer discovers or is notified by an independent public accountant of a material weakness as defined in Rule 17a-5, the broker-dealer must: (1) give notice to the Commission within twenty-four hours of the discovery or notification of the material weakness; and (2) transmit a report within forty-eight hours of the notice stating

⁸¹³ Compare 17 CFR 240.17a-11(d), with paragraph (d) of proposed Rule 18a-8.

⁸¹⁴ See paragraph (d) of proposed Rule 18a-8. As discussed above in section II.A.2.a. of this release, proposed Rule 18a-5 – which is modeled on Rule 17a-3 – would require stand-alone SBSBs, stand-alone MSBSPs, bank SBSBs, and bank MSBSPs to make and keep current certain records.

⁸¹⁵ See paragraph (d) of proposed Rule 18a-8.

⁸¹⁶ See Broker-Dealer Reports, 78 FR at 51993. As discussed above in section II.B.3.a. of this release, under the recently adopted amendments to Rule 17a-5, the concept of material weakness is used for the purposes of the compliance report and the report of the independent public accountant covering the compliance report. See 17 CFR 240.17a-5(d)(3). A material weakness is defined in Rule 17a-5 to mean a deficiency, or a combination of deficiencies, in Internal Control Over Compliance (as that term is defined in the rule) such that there is a reasonable possibility that non-compliance with Rule 15c3-1 or paragraph (e) of Rule 15c3-3 will not be prevented or detected on a timely basis or that non-compliance to a material extent with Rule 15c3-3, except for paragraph (e), Rule 17a-13, or any Account Statement Rule will not be prevented or detected on a timely basis. See 17 CFR 240.17a-5(d)(3)(iii). The recently amended rule further provides that a deficiency in Internal Control Over Compliance exists when the design or operation of a control does not allow the management or employees of the broker or dealer, in the normal course of performing their assigned functions, to prevent or detect on a timely basis non-compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or any Account Statement Rule. See *id.* The term Internal Control Over Compliance means internal controls that have the objective of providing the broker-dealer with reasonable assurance that non-compliance with Rule 15c3-1, Rule 15c3-3, Rule 17a-13, or any Account Statement Rule will be prevented or detected on a timely basis. See 17 CFR 240.17a-5(d)(3)(ii).

what the broker-dealer has done or is doing to correct the situation.⁸¹⁷ As broker-dealers, dually registered broker-dealer SBSBs and broker-dealer MSBSBs will be required to comply with the existing notification requirements in paragraph (e).⁸¹⁸

The Commission is proposing to include a parallel material weakness notification requirement in proposed Rule 18a-7 applicable to stand-alone SBSBs that is modeled on paragraph (e) of Rule 17a-11.⁸¹⁹ Specifically, paragraph (e) of Rule 18a-8 would provide that, whenever a stand-alone SBSB discovers or is notified by an independent public accountant of a material weakness as defined in Rule 18a-7, the SBSB must: (1) give notice to the Commission within twenty-four hours of the discovery or notification of the material weakness; and (2) transmit a report within forty-eight hours of the notice indicating what the SBSB has done or is doing to correct the situation.⁸²⁰

⁸¹⁷ See Broker-Dealer Reports, 78 FR at 51993. Paragraph (i) of Rule 17a-12 requires an OTC derivatives dealer to take the same steps when it discovers or is notified of a material inadequacy as defined in Rule 17a-12. Rule 17a-12 – the reporting rule for OTC derivatives dealers – is similar to Rule 17a-5. See 17 CFR 240.17a-12. However, rather than using the concept of material weakness, Rule 17a-12 uses the concept of material inadequacy. See *id.* The Commission replaced the use of material inadequacy with material weakness in Rule 17a-5 through the recent amendments to the rule, which were designed, among other things, to (1) increase the focus of carrying broker-dealers and their independent public accountants on compliance, and internal control over compliance, with certain financial and custodial requirements; and (2) strengthen and clarify broker-dealer audit and reporting requirements in order to facilitate consistent compliance with these requirements. See Broker-Dealer Reports, 78 FR at 51911. As discussed above in section II.B.3.a. of this release, the Commission is proposing to use the concept of material weakness in proposed Rule 18a-7.

⁸¹⁸ As discussed above, paragraph (e) of Rule 17a-11 would be redesignated paragraph (d). Further, as discussed below in section II.C.3. of this release, the Commission is proposing certain largely technical amendments to the text in paragraph (e), which would be contained in paragraph (d) of Rule 17a-5, as proposed to be amended.

⁸¹⁹ Compare 17 CFR 240.17a-11(e), with paragraph (e) of proposed Rule 18a-8. As discussed above in section II.B.3.a. of this release, stand-alone MSBSBs would not be required to file with the Commission a compliance report or a report of the independent public accountant covering the compliance report. Consequently, as the concept of material weakness is used in the context of these reports, the material weakness notification requirement would not apply or be relevant to stand-alone MSBSBs. Further, as discussed above in section II.B.3.a. of this release, bank SBSBs and bank MSBSBs would not be subject to the requirements in proposed Rule 18a-7 to file annual reports with the Commission. Consequently, the material weakness notification requirement would not apply or be relevant to these registrants.

⁸²⁰ See paragraph (e) of proposed Rule 18a-8.

Insufficient Liquidity Reserves

As discussed above in section II.A. of this release, the Commission has proposed amendments to Rule 15c3-1 that would establish liquidity stress test requirements for ANC broker-dealers, which would include ANC broker-dealer SBSBs.⁸²¹ Further, the Commission has proposed identical liquidity stress test requirements for stand-alone ANC SBSBs as part of the capital requirements for SBSBs.⁸²² Under the proposed liquidity stress test requirements, ANC broker-dealers, including ANC broker-dealer SBSBs, and stand-alone ANC SBSBs would be required, among other things, to: (1) perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for thirty consecutive days; and (2) maintain at all times liquidity reserves based on the results of the liquidity stress test comprised of unencumbered cash or U.S. government securities.⁸²³

Given the importance to the health of a financial institution of maintaining adequate liquidity, the Commission is proposing a new notification requirement that would apply to ANC broker-dealers, including ANC broker-dealer SBSBs.⁸²⁴ Specifically, paragraph (e) of Rule 17a-5, as proposed to be amended, would require an ANC broker-dealer to give immediate notice in writing if the liquidity stress test conducted pursuant to Rule 15c3-1, as proposed to be amended, indicates that the amount of the firm's liquidity reserve is insufficient.⁸²⁵ The

⁸²¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252-70254.

⁸²² See id.

⁸²³ See id.

⁸²⁴ See paragraph (e) of Rule 17a-5, as proposed to be amended. As discussed above, current paragraph (e) of Rule 17a-5 would be redesignated paragraph (d).

⁸²⁵ See paragraph (e) of Rule 17a-11, as proposed to be amended. Current paragraph (f) of Rule 17a-11 provides that every national securities exchange or national securities association that learns that a member broker-dealer has failed to send notice or transmit a report as required by paragraphs (b), (c), (d), or (e) of Rule 17a-11, even after being advised by the securities exchange or the national securities association to send notice or transmit a report, shall immediately give notice of such failure in accordance with paragraph (g) of Rule 17a-11. See 17 CFR 240.17a-11(f). As discussed above, the Commission is proposing to

Commission is proposing to include a parallel liquidity notification requirement in proposed Rule 18a-8 applicable to stand-alone ANC SBSBs.⁸²⁶ The proposed liquidity notification requirements are designed to provide the Commission with notice of a liquidity shortfall at an ANC broker-dealer or stand-alone ANC SBSB that could impair the ability of the firm to withstand a liquidity crisis.

Failure to Make a Required Reserve Deposit

As discussed above in section II.A. of this release, Rule 15c3-3 requires a carrying broker-dealer to maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers, and proposed Rule 18a-4 would include a parallel requirement with respect to security-based swap customers applicable to SBSBs, including broker-dealer SBSBs.⁸²⁷ Under paragraph (i) of Rule 15c3-3, a broker-dealer is required to notify the Commission and its DEA if it fails to make a required deposit into its customer reserve account under Rule 15c3-3.⁸²⁸ Since a broker-dealer SBSB would be required to maintain a separate reserve account for its security-based swap customers under Rule 18a-4, the Commission is proposing a new notification requirement in Rule 17a-11 that would be triggered if a broker-dealer fails to make a required deposit into its security-based swap customer reserve account.⁸²⁹ In addition, the Commission is proposing to include a parallel reserve

redesignate current paragraph (f) as paragraph (g). Further, the Commission is proposing to replace the specific reference to “paragraphs (b), (c), (d), or (e)” of Rule 17a-11 in current paragraph (f) with a reference to “this section”. This would incorporate all the notices required under Rule 17a-11, including notices that would be required under the new liquidity notification requirement. See paragraph (g) of Rule 17a-11, as proposed to be amended.

⁸²⁶ Compare paragraph (e) of Rule 17a-11, as proposed to be amended, with paragraph (f) of proposed Rule 18a-8.

⁸²⁷ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70282–70287.

⁸²⁸ See 17 CFR 240.15c3-3(i).

⁸²⁹ See paragraph (f) of Rule 17a-11, as proposed to be amended. As discussed above, current paragraph (f) of Rule 17a-5 would be redesignated paragraph (g).

account notification requirement in proposed Rule 18a-8 applicable to stand-alone SBSDBs and bank SBSDBs.⁸³⁰

Manner of Notification

Paragraph (g) of Rule 17a-11 provides that every notice or report required to be given or transmitted by the rule shall be given or transmitted to the principal office of the Commission in Washington, DC, the regional office of the Commission for the region in which the broker-dealer has its principal place of business, the DEA of which such broker-dealer is a member, and the CFTC if the broker-dealer is registered as an FCM.⁸³¹

Paragraph (g) further provides that for the purposes of Rule 17a-11, notice shall be given or transmitted by telegraphic notice or facsimile transmission and that a report about how the broker-dealer is addressing a failure to make and keep current books and records or a material weakness may be transmitted by overnight delivery.⁸³² The Commission is proposing to amend this paragraph to no longer permit notice by telegraphic transmission, and instead to only allow notice by facsimile transmission.⁸³³ This proposal recognizes that telegrams are no longer widely used in the U.S.,⁸³⁴ and that Commission staff no longer receive Rule 17a-11 notices by telegram. As broker-dealers, dually registered broker-dealer SBSDBs and broker-dealer MSBSPs will be required to give notice or transmit the notices and reports, including the proposed new notices, pursuant to the requirements specified in paragraph (g).⁸³⁵

⁸³⁰ Compare paragraph (h) of Rule 17a-11, as proposed to be amended, with paragraph (g) of proposed Rule 18a-8.

⁸³¹ See 17 CFR 240.17a-11(g).

⁸³² See *id.*

⁸³³ See paragraph (h) of Rule 17a-11, as proposed to be amended.

⁸³⁴ See Tom Standage, *No Morse*, L.A. Times, Feb. 8, 2006, at B15 (noting that Western Union discontinued its telegram services effective January 27, 2006).

⁸³⁵ As discussed above, paragraph (g) of Rule 17a-11 would be redesignated paragraph (h). Further, as discussed below in section II.C.3. of this release, the Commission is proposing certain largely technical

The Commission is proposing to include a parallel manner of notification requirement in proposed Rule 18a-8 that is modeled on paragraph (g) of Rule 17a-11.⁸³⁶ Specifically, paragraph (i) of proposed Rule 18a-8 would provide that a stand-alone SBSB, stand-alone MSBSP, bank SBSB, or bank MSBSP required to give notice or transmit a report under the rule would need to do so in the same manner as a broker-dealer under paragraph (g) of Rule 17a-11, except there would be no requirement to give notice or provide a report to a DEA as these registrants would not have DEAs.⁸³⁷

Request for Comment

The Commission generally requests comment on the proposed amendments to Rule 17a-11 and proposed Rule 18a-9. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following question:

1. Should paragraph (f) of Rule 17a-11 be amended to require a broker-dealer's DEA (in addition to a broker-dealer's national securities exchange or national securities association) to transmit notice to the Commission upon learning that a broker-dealer failed to send notice in accordance with Rule 17a-11? If so, explain why. If not, explain why not. For example, given the responsibilities of a DEA, is a DEA more likely to learn if a broker-dealer for which it serves as DEA has failed to send notice in accordance with Rule 17a-11 than a national securities exchange or national securities association of which the broker-dealer is a member? Commenters are asked to provide information and data about the costs and benefits of requiring the DEA to provide notice.

amendments to the text in paragraph (g), which would be contained in paragraph (h) of Rule 17a-5, as proposed to be amended.

⁸³⁶ Compare 17 CFR 240.17a-11(g), with paragraph (h) of proposed Rule 18a-8.

⁸³⁷ See paragraph (h) of proposed Rule 18a-8.

2. Rule 17a-11 is proposed to be amended to include new notification requirements applicable to broker-dealers (e.g., requiring notice if the broker-dealer's liquidity stress test indicates that the amount of its liquidity reserve is insufficient). Consequently, this would expand the types of instances in which a national securities exchange or national securities association would be required to give notice under paragraph (g) of Rule 17a-11, as proposed to be amended, if the exchange or association learns that a broker-dealer has failed to do so under Rule 17a-11. Would this expansion materially increase the number of notices that would need to be sent by national securities exchanges and national securities associations under Rule 17a-11? If so, please explain why and quantify the increased burden resulting from the increased number of notices that would need to be sent.

3. Additional Proposed Amendments to Rule 17a-11

The Commission is proposing several amendments to Rule 17a-11 to eliminate obsolete text, improve readability, and modernize terminology. The Commission is proposing a global change to Rule 17a-11 that would replace the use of the word "shall" in the rule with the word "must" or "will" where appropriate.⁸³⁸ The Commission also proposes to make certain stylistic, corrective, and punctuation amendments to improve Rule 17a-11's readability.⁸³⁹

⁸³⁸ The proposed amendments would replace the word "shall" with the word "must" or "will" in the following paragraphs of Rule 17a-11, as proposed to be amended: (a)(1), (a)(2), (b), (c), (g), (h), and (j). See Rule 17a-11, as proposed to be amended.

⁸³⁹ The Commission proposes the following stylistic and corrective changes to Rule 17a-11, as proposed to be amended: (1) replacing the phrase "this § 240.17a-11" with the phrase "this section" in paragraph (a)(1); (2) replacing the phrase "Every broker or dealer who" with the phrase "Every broker or dealer that" in paragraph (c); (3) replacing the phrase "such discovery or notification of the material inadequacy or the material weakness" with the phrase "the discovery or notification of the material inadequacy or material weakness" in paragraph (d)(1); and (4) removing the U.S.C. citations from paragraph (j) since the rule already cites to the applicable section of the Exchange Act.

As a consequence of the proposed deletion of paragraph (a), paragraphs (b), (c), (d), and (e) of Rule 17a-11 would be redesignated paragraphs (a), (b), (c), and (d), respectively. Further, as discussed above, the Commission is proposing to add two new notification provisions to Rule 17a-11 that would be codified in paragraphs (e) and (f) of the rule, as proposed to be amended. As a consequence of the deletion of paragraph (a) and the addition of the two new provisions, paragraphs (f), (g), (h), and (i) would be redesignated paragraphs (g), (h), (i), and (j), respectively. Similarly, due to the proposed addition and deletion of paragraphs, the Commission is proposing a global change that would replace the cross-references to “paragraph (g)” of Rule 17a-11 with “paragraph (h)” of Rule 17a-11.⁸⁴⁰

Reference is made in paragraph (g) to a “member” of a national securities exchange as a distinct class of registrant in addition to a “broker” and “dealer”. The Commission is proposing to remove this reference to a “member” given that the rule applies to brokers-dealers, which would include a member of a national securities exchange that is a broker-dealer.

The Commission is also proposing to replace a specific reference to the notices required under “paragraphs (b), (c), (d), or (e)” of Rule 17a-11 in current paragraph (f) with a reference to “this section”. This would incorporate all the notices required under Rule 17a-11, including notices that would be required under the new security-based swap customer reserve account notification requirement.

Finally, the Commission proposes to amend paragraph (i) to reference “§ 240.15c3-1, § 240.15c3-1d, § 240.15c3-3, § 240.17a-5, and § 240.17a-12” instead of “§ 240.15c3-1(a)(6)(iv)(B), § 240.15c3-1(a)(6)(v), § 240.15c3-1(a)(7)(ii),

⁸⁴⁰ The proposed amendments would replace the phrase “paragraph (g)” with the phrase “paragraph (h)” in the following paragraphs of Rule 17a-11, as proposed to be amended: (a)(1), (b), (c), (d)(1), (d)(2), and (g). See Rule 17a-11, as proposed to be amended.

§ 240.15c3-1(c)(2)(x)(B)(1), § 240.15c3-1(e), § 240.15c3-1d(c)(2), § 240.15c3-3(i), § 240.17a-5(h)(2), and § 240.17a-12(f)(2)". This proposed amendment corrects certain cross-references that are outdated due to the recently adopted amendments to some of these rules.⁸⁴¹ It also eliminates cross-references to specific paragraphs in the event of future amendments to these cross-referenced rules.

Request for Comment

The Commission generally requests comment on these additional proposed amendments to Rule 17a-11, including comment on whether any of the proposed amendments would result in substantive changes to the requirements applicable to broker-dealers.

D. Quarterly Securities Count and Capital Charge for Unresolved Securities Differences

1. Introduction

As discussed above, section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.⁸⁴² Section 15F(f)(2) provides that the Commission shall adopt rules governing reporting and recordkeeping for SBSDs and MSBSPs.⁸⁴³ Further, section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.⁸⁴⁴ In addition, section 15F(f)(1)(B)(ii) provides that nonbank SBSDs and nonbank MSBSPs shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁸⁴⁵

⁸⁴¹ See Broker-Dealer Reports, 78 FR 51910; Financial Responsibility Rules for Broker-Dealers, 78 FR 51824.

⁸⁴² See Pub. L. 111-203, 764; 15 U.S.C. 78o-10.

⁸⁴³ See 15 U.S.C. 78o-10(f)(2).

⁸⁴⁴ See 15 U.S.C. 78o-10(f)(1)(A).

⁸⁴⁵ See 15 U.S.C. 78o-10(f)(1)(B)(ii).

After considering the anticipated business activities of nonbank SBSDs, the Commission is proposing to establish a securities count program for these registrants under sections 15F that is modeled on the securities count program for broker-dealers codified in Rule 17a-13.⁸⁴⁶ Rule 17a-13 requires certain broker-dealers (generally, broker-dealers that hold funds and securities) to examine and count the securities they physically hold, account for the securities that are subject to their control or direction but are not in their physical possession, verify the locations of securities under certain circumstances, and compare the results of the count and verification with their records.⁸⁴⁷

Like Rule 17a-11, Rule 17a-13 was adopted in the aftermath of the securities industry “paper work” crisis of 1967-1970.⁸⁴⁸ At that time, the Commission identified several factors contributing to the crisis, including, that securities were not checked and counted frequently enough nor controlled tightly enough.⁸⁴⁹ The Commission also identified corrective measures to counter these conditions in the future,⁸⁵⁰ including requiring broker-dealers to conduct quarterly security counts as part of the effort to eliminate the “deficiencies in broker-dealers’ internal controls and procedures for safeguarding securities reflected by material amounts of unresolved

⁸⁴⁶ See 17 CFR 240.17a-13.

⁸⁴⁷ See *id.* As noted in section I. of this release, the Dodd-Frank Act amended the definition of security in section 3(a)(10) of the Exchange Act to include a security-based swap. See Pub. L. 111-203, 761(a)(2); 15 U.S.C. 78c(a)(10). Therefore, each reference in Rule 17a-13 to a security in the Exchange Act includes a security-based swap. The Commission, however, has issued temporary exemptive relief excluding security-based swaps from the definition of security to the extent Commission rules did not otherwise apply specifically to security-based swaps prior to the amendment. See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, 76 FR 39927.

⁸⁴⁸ See Quarterly Securities Counts by Certain Exchange Members, Brokers and Dealers, Exchange Act Release No. 9140 (Apr. 19, 1971), 36 FR 7974 (Apr. 28, 1971); Net Capital Requirements for Brokers and Dealers; Amended Rules, Exchange Act Release No. 18417 (Jan. 13, 1982), 47 FR 3512 (Jan. 25, 1982).

⁸⁴⁹ See Study of Unsafe and Unsound Practices of Brokers and Dealers at 2.

⁸⁵⁰ See *id.* at 3-5.

security differences, suspense balances and unverified transfer items.”⁸⁵¹ As the Commission stated when proposing Rule 17a-13,

One of a broker-dealer's major functions is that of moving funds from buyer to seller in exchange for securities. The movement of these funds and securities is monitored and directed by the books and records of the broker-dealers involved in the various transactions. To the extent that a firm's records do not accurately reflect the movement and location of funds and securities, the ability of that firm to operate efficiently and even its continued viability come into question. The insolvency of many broker-dealers in the past few years is attributable to a large extent to their loss of operational control. Once a firm's operations reach a certain level of errors, it is a Herculean task, requiring extraordinary sums of capital, to reverse the process and to resolve past errors so that the firm's present records accurately reflect its position. That part of the broker-dealer's operations dealing with the movement and location of securities has, in the past, been subject only to the once-a-year check of the X-17A-5 audit. The accounting record for the location and movement of securities is the stock record. The annual audit may disclose differences between positions reflected in the stock record and the results of a physical count of securities and verification of securities positions outside the firm. Many accountants have advised and urged their clients to make regular periodic box counts, but this advice has not always been followed. Furthermore, some firms have failed to research and resolve promptly stock record differences.⁸⁵²

Rule 17a-13 continues to play an important role today, given the volume of securities transactions and the resulting movement of securities between control locations and broker-dealers.

Under the proposed securities count program for SBSs, broker-dealer SBSs and broker-dealer MSBSPs – as broker-dealers – would be subject to Rule 17a-13. Consequently, they will be required to comply with the existing securities count requirements in the rule.

⁸⁵¹ Id. at 30.

⁸⁵² Quarterly Securities Counts by Certain Exchange Members, Brokers and Dealers, 36 FR at 7974.

Stand-alone SBSBs would be subject to proposed Rule 18a-9, which is modeled on Rule 17a-13. Proposed Rule 18a-9 would not include a parallel requirement for every requirement in Rules 17a-13.⁸⁵³ In addition, proposed Rule 18a-9 would not apply to stand-alone MSBSBs because the customer protection rationale for Rule 17a-13 and proposed Rule 18a-9 is not as pertinent to stand-alone MSBSBs. For example, the Commission preliminarily does not anticipate that stand-alone MSBSBs will engage in securities operations involving the movement of funds and securities from buyer to seller that are as complex as the operations of dealers in securities such as broker-dealers and SBSBs. Finally, for the reasons discussed above in section I. of this release, proposed Rule 18a-9 would not apply to bank SBSBs and bank MSBSBs.

2. Proposed Rule 18a-9

Undesignated Introductory Paragraph

Proposed Rule 18a-9 contains an undesignated introductory paragraph explaining that the rule applies only to an SBSB that is not dually registered as a broker-dealer (i.e., a stand-alone SBSB), provided, however, that the rule does not apply to an SBSB with a prudential regulator (i.e., a bank SBSB).⁸⁵⁴ The note further explains that a broker-dealer, including a broker-dealer that is dually registered as an SBSB, is subject to the securities count requirements under Rule 17a-13.⁸⁵⁵

⁸⁵³ The Commission is not proposing to include in proposed Rule 18a-9 provisions that would parallel the provisions in paragraphs (a)(1), (a)(2), (a)(3), and (e) of Rule 17a-13. These paragraphs of Rule 17a-13 provide exemptions from complying with Rule 17a-13 for certain types of broker-dealers. See 17 CFR 240.17a-13(a)(1), (a)(2), (a)(3), and (e). The Commission preliminarily believes that SBSBs will not limit their activities to the types of activities in which the exempt broker-dealers engage. However, the Commission is requesting comment below on this question.

⁸⁵⁴ See undesignated introductory paragraph of proposed Rule 18a-9.

⁸⁵⁵ See id.

Requirement to Perform a Securities Count

Paragraph (b) of Rule 17a-13 prescribes the requirement to perform a quarterly securities count and specifies the steps a broker-dealer must take in performing a count. Specifically, it requires a broker-dealer to at least once in each calendar quarter:

- Physically examine and count all securities held including securities that are the subjects of repurchase or reverse repurchase agreements;⁸⁵⁶
- Account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to the broker-dealer's control or direction but not in the broker-dealer's physical possession by examination and comparison of the supporting detail records with the appropriate ledger control accounts;⁸⁵⁷
- Verify all securities in transfer, in transit, pledge, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to the broker-dealer's control or direction but not in the broker-dealer's physical possession, where such securities have been in said status for longer than thirty days;⁸⁵⁸
- Compare the results of the count and verification with the broker-dealer's records;⁸⁵⁹ and
- Record on the books and records of the broker-dealer all unresolved differences setting forth the security involved and date of comparison in a security count difference account no later than seven business days after the date of each required quarterly security examination, count, and verification in accordance with the requirements provided in paragraph (c) of the Rule.⁸⁶⁰

In general terms, the rule requires a broker-dealer to physically examine, count and verify all securities positions (e.g., equities, corporate bonds, and government securities, and, after the Commission's exemptive relief expires, security-based swaps), and to compare the results of the

⁸⁵⁶ See 17 CFR 240.17a-13(b)(1).

⁸⁵⁷ See 17 CFR 240.17a-13(b)(2).

⁸⁵⁸ See 17 CFR 240.17a-13(b)(3).

⁸⁵⁹ See 17 CFR 240.17a-13(b)(4).

⁸⁶⁰ See 17 CFR 240.17a-13(b)(5). This paragraph further provides that no examination, count, verification, and comparison for the purpose of the rule shall be within two months of or more than four months following a prior examination, count, verification, and comparison made hereunder. See id.

count and verification with the firm's records at least once each calendar quarter. A securities count difference results when the count reflects positions different than those reflected in the firm's books and records. As discussed above in section II.A.2.a. of this release, a broker-dealer's securities record consists of a "long" side and a "short" side. The "long" side of the record accounts for the broker-dealer's responsibility as a custodian of securities and shows, for example, the securities the firm has received from customers and securities owned by the broker-dealer. The "short" side of the record shows where the securities are located such as at a securities depository. A short securities difference occurs when the amount of securities on the "long" side of the securities record are greater than the amount of securities on the "short" side of the securities. A long securities difference occurs when the opposite is true. The rule requires the firm to record on its books and records any unresolved differences within seven business days after the date of each required count. The seven business days should be measured from the date of the commencement of the count. A broker-dealer must take a capital charge for short securities differences outstanding seven business days or more and for long securities differences where the securities have been sold before they are adequately resolved.⁸⁶¹

The Commission is proposing to include parallel securities count requirements in proposed Rule 18a-9 that would mirror the requirements in paragraph (b) of Rule 17a-13.⁸⁶² Consequently, a stand-alone SBSB would be required to perform a securities count each quarter following steps specified in paragraph (a) of Rule 18a-9 that are identical to the steps specified in

⁸⁶¹ See 17 CFR 240.15c3-1(c)(2)(v).

⁸⁶² Compare 17 CFR 240.17a-13(b), with paragraph (a) of proposed Rule 18a-9.

paragraph (b) of Rule 17a-13.⁸⁶³ Moreover, a securities count would need to be performed no sooner than two months after the last count and no later than four months after the last count.⁸⁶⁴

Date of the Count

Paragraph (c) of Rule 17a-13 provides that: (1) the examination, count, verification, and comparison may be made either as of a date certain or on a cyclical basis covering the entire list of securities; (2) in either case the recordation shall be effected within seven business days subsequent to the examination, count, verification, and comparison of a particular security; (3) in the event that an examination, count, verification, and comparison is made on a cyclical basis, it shall not extend over more than one calendar quarter-year; and (4) no security shall be examined, counted, verified, or compared for the purpose of the rule less than two months or more than four months after a prior examination, count, verification, and comparison.⁸⁶⁵ This permits a broker-dealer to perform the securities count on a rolling basis throughout the quarter as opposed to all in one day. For example, on day one the broker-dealer could perform the count with respect to securities of ABC Corporation, on day two the broker-dealer could perform the count with respect to securities of DEF Corporation, and on day three the broker-dealer could perform the count with respect to securities of GHI Corporation.

The Commission is proposing to include a parallel securities count requirement in proposed Rule 18a-9 that would mirror the requirement in paragraph (c) of Rule 17a-13.⁸⁶⁶ Consequently, a stand-alone SBSB could perform the securities count as of a date certain or on a

⁸⁶³ See paragraph (a) of proposed Rule 18a-9.

⁸⁶⁴ See *id.*

⁸⁶⁵ See 17 CFR 240.17a-13(c).

⁸⁶⁶ Compare 17 CFR 240.17a-13(c), *with* paragraph (b) of proposed Rule 18a-9.

cyclical basis subject conditions that are identical to the conditions in paragraph (c) of Rule 17a-13.⁸⁶⁷

Separation of Duties

Paragraph (d) of Rule 17a-13 provides that the examination, count, verification, and comparison shall be made or supervised by persons whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of the subject records.⁸⁶⁸ Thus, the rule requires a separation of duties as a control to promote the integrity of the securities count process.⁸⁶⁹

The Commission is proposing to include a parallel separation of duties requirement in proposed Rule 18a-9 that would mirror the requirement in paragraph (d) of Rule 17a-13.⁸⁷⁰ Consequently, a stand-alone SBSB would need to assign responsibility for making or supervising the count to individuals whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of the subject records.⁸⁷¹

Exemptions

Paragraph (f) of Rule 17a-13 provides that the Commission may, upon written request, exempt from the provisions of the rule, either unconditionally or on specified terms and conditions, any broker-dealer that satisfies the Commission it is not necessary in the public interest and for the protection of investors to subject the firm to certain or all of the provisions of the rule, because of the special nature of the firm's business, the safeguards the firm has

⁸⁶⁷ See paragraph (b) of proposed Rule 18a-9.

⁸⁶⁸ See 17 CFR 240.17a-13(d).

⁸⁶⁹ See *id.*

⁸⁷⁰ Compare 17 CFR 240.17a-13(d), with paragraph (c) of proposed Rule 18a-9.

⁸⁷¹ See paragraph (c) of proposed Rule 18a-9.

established for the protection of customers' funds and securities, or such other reason as the Commission deems appropriate.⁸⁷²

The Commission is proposing to include a parallel exemption provision in proposed Rule 18a-9 that would mirror the provision in paragraph (f) of Rule 17a-13.⁸⁷³ Consequently, a stand-alone SBSB could seek an exemption from proposed Rule 18a-9 or from a specific requirement in the rule.⁸⁷⁴ The standard for granting such requests would be the same standard as is used for granting exemptions from Rule 17a-13.

Request for Comment

The Commission generally requests comment on proposed Rule 18a-9. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are there any categories of stand-alone SBSBs to which proposed Rule 18a-9 should not apply? If so, explain why.
2. Should proposed Rule 18a-9 apply to stand-alone MSBSPs? If so, explain why. Should proposed Rule 18a-9 apply to bank SBSBs? If so, explain why. Should proposed Rule 18a-9 apply to bank MSBSPs? If so, explain why.
3. How should security-based swaps be treated with respect to the requirements in Rule 17a-13 and proposed Rule 18a-9 to examine and count the securities they physically hold, account for the securities that are subject to their control or direction but are not in their physical possession, verify the locations of securities under certain circumstances, and compare the results of the count and verification with their records?

⁸⁷² See 17 CFR 240.17a-13(f).

⁸⁷³ Compare 17 CFR 240.17a-13(f), with paragraph (d) of proposed Rule 18a-9.

⁸⁷⁴ See paragraph (d) of proposed Rule 18a-9.

3. Capital Charge

As discussed above, Rule 15c3-1 requires a broker-dealer to take a capital charge for short securities differences that are unresolved for seven days or longer and for long securities differences where the securities have been sold before they are adequately resolved.⁸⁷⁵ The Commission's proposed capital rule for stand-alone SBSDs is modeled closely on Rule 15c3-1 but the proposal did not include these types of capital charges.⁸⁷⁶ The failure to include these capital charges in proposed Rule 18a-1 was inadvertent and, consequently, the Commission is proposing to include them in the rule.

Request for Comment

The Commission generally requests comment on this proposed capital charge. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed capital appropriate for stand-alone SBSDs? If not, explain why.

III. GENERAL REQUEST FOR COMMENT

The Commission invites comment, including relevant data and analysis, regarding all aspects of the proposed rules. The Commission also requests comment on appropriate effective dates for the proposals, including whether it would be appropriate to stagger or delay the effective dates for the requirements based on the nature or characteristics of the activities or entities to which they would apply.

⁸⁷⁵ See 17 CFR 240.15c3-1(c)(2)(v).

⁸⁷⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70214.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the rule amendments and new rules proposed in this release would contain a new "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").⁸⁷⁷ The Commission is submitting the proposed rule amendments and proposed new rules to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA. An agency may not conduct or sponsor, and a person is not required to respond to a collection of information unless it displays a currently valid OMB control number. The titles for the collections of information are:

- (1) Rule 17a-3 – Records to be made by certain brokers and dealers (OMB control number 3235-0033);
- (2) Rule 17a-4 – Records to be preserved by certain brokers and dealers (OMB control number 3235-0279);
- (3) Rule 17a-5 – Reports to be made by certain brokers and dealers (OMB control number 3235-0123);
- (4) Rule 17a-11 – Notification provisions for brokers and dealers (OMB control number 3235-0085);
- (5) Rule 18a-5 – Records to be made by certain security-based swap dealers and major security-based swap participants (a proposed new collection of information);
- (6) Rule 18a-6 – Records to be preserved by certain security-based swap dealers and major security-based swap participants (a proposed new collection of information);

⁸⁷⁷ See 44 U.S.C. 3501 *et seq.*; 5 CFR 1320.11.

- (7) Rule 18a-7 – Reports to be made by certain security-based swap dealers and major security-based swap participants (a proposed new collection of information);
- (8) Rule 18a-8 – Notification provisions for security-based swap dealers and major security-based swap participants (a proposed new collection of information);
- (9) Rule 18a-9 – Quarterly security counts to be made by certain security-based swap dealers (a proposed new collection of information); and
- (10) Form SBS (a proposed new collection of information).

The burden estimates contained in this section do not include any other possible costs or economic effects beyond the burdens required to be calculated for PRA purposes.

A. Summary of Collections of Information Under The Proposed Rules And Proposed Rule Amendments

1. Proposed Amendments to Rule 17a-3 and Proposed Rule 18a-5

Section 764 of the Dodd-Frank Act added section 15F(f)(2) to the Exchange Act, which provides that the Commission shall adopt rules governing reporting and recordkeeping for SBSDs and MSBSPs.⁸⁷⁸ Rule 17a-3 requires a broker-dealer to make and keep current certain records.⁸⁷⁹ The Commission is proposing to amend this rule to account for the security-based swap and swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs. With respect to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, the Commission is proposing new Rule 18a-5 – which is modeled on Rule 17a-3, as proposed to be amended – to require these registrants to make and keep current certain

⁸⁷⁸ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10(f)(2).

⁸⁷⁹ See 17 CFR 240.17a-3.

records.⁸⁸⁰ Proposed Rule 18a-5 would not include a parallel requirement for every requirement in Rule 17a-3 because some of the requirements in Rule 17a-3 relate to activities that are not expected or permitted of SBSDs and MSBSPs. Further, the proposed recordkeeping requirements for bank SBSDs and bank MSBSPs are tailored specifically to their activities as an SBSD or an MSBSP because: (1) the Commission's authority under section 15F(f) of the Exchange Act is tied to activities related to the SBSD or MSBSP business; (2) bank SBSDs and bank MSBSPs are subject to recordkeeping requirements applicable to banks; and (3) the prudential regulators – rather than the Commission – establish and monitor capital, margin, and other prudential requirements applicable to bank SBSDs and bank MSBSPs.

The proposed amendments to Rule 17a-3 and proposed Rule 18a-5 would establish a number of new collections of information, as summarized in the table below.

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	Non-model stand-alone SBSDs	ANC stand-alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
Trade blotters	17a-3(a)(1)*	17a-3(a)(1)*	17a-3(a)(1)*	17a-3(a)(1)*	18a-5(a)(1)	18a-5(a)(1)	18a-5(b)(1)	18a-5(a)(1)
General ledger					18a-5(a)(2)	18a-5(a)(2)		18a-5(a)(2)
Ledgers for customer and non-customer accounts	17a-3(a)(3)*	17a-3(a)(3)*	17a-3(a)(3)*	17a-3(a)(3)*	18a-5(a)(3)	18a-5(a)(3)	18a-5(b)(2)	18a-5(a)(3)
Stock record	17a-3(a)(5)*	17a-3(a)(5)*	17a-3(a)(5)*	17a-3(a)(5)*	18a-5(a)(4)	18a-5(a)(4)	18a-5(b)(3)	18a-5(a)(4)
Memoranda of brokerage orders	17a-3(a)(6)*	17a-3(a)(6)*	17a-3(a)(6)*	17a-3(a)(6)*			18a-5(b)(4)	
Memoranda of proprietary orders	17a-3(a)(7)*	17a-3(a)(7)*	17a-3(a)(7)*	17a-3(a)(7)*	18a-5(a)(5)	18a-5(a)(5)	18a-5(b)(5)	18a-5(a)(5)
Confirmations	17a-3(a)(8)*	17a-3(a)(8)*	17a-3(a)(8)*	17a-3(a)(8)*	18a-5(a)(6)	18a-5(a)(6)	18a-5(b)(6)	18a-5(a)(6)
Accountholder information	17a-3(a)(9)*	17a-3(a)(9)*	17a-3(a)(9)*	17a-3(a)(9)*	18a-5(a)(7)	18a-5(a)(7)	18a-5(b)(7)	18a-5(a)(7)
Options positions					18a-5(a)(8)	18a-5(a)(8)		18a-5(a)(8)
Trial balances and computation of net capital					18a-5(a)(9)	18a-5(a)(9)		18a-5(a)(9)
Associated person's employment application					18a-5(a)(10)	18a-5(a)(10)	18a-5(b)(8)	18a-5(a)(10)
Liquidity stress test			17a-3(a)(24)			18a-5(a)(11)		
Account equity		17a-3(a)(25)	17a-3(a)(25)	17a-3(a)(25)	18a-5(a)(12)	18a-5(a)(12)		18a-5(a)(12)

⁸⁸⁰

See proposed Rule 18a-5.

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	Non-model stand-alone SBSDs	ANC stand-alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
and margin calculations under proposed Rule 18a-3								
Possession or control requirements under proposed Rule 18a-4		17a-3(a)(26)	17a-3(a)(26)		18a-5(a)(13)	18a-5(a)(13)	18a-5(b)(9)	
Customer reserve requirements under proposed Rule 18a-4		17a-3(a)(27)	17a-3(a)(27)		18a-5(a)(14)	18a-5(a)(14)	18a-5(b)(10)	
Unverified transactions		17a-3(a)(28)	17a-3(a)(28)	17a-3(a)(28)	18a-5(a)(15)	18a-5(a)(15)	18a-5(b)(11)	18a-5(a)(15)
Political contributions		17a-3(a)(29)	17a-3(a)(29)		18a-5(a)(16)	18a-5(a)(16)	18a-5(b)(12)	
Compliance with external business conduct requirements		17a-3(a)(30)	17a-3(a)(30)	17a-3(a)(30)	18a-5(a)(17)	18a-5(a)(17)	18a-5(b)(13)	18a-5(a)(17)

* Broker-dealers are currently required to comply with these paragraphs of Rule 17a-3, but the Commission proposes to amend these paragraphs to tailor the types of records that should be made and kept with respect to security-based swaps, and to make certain technical changes.

2. Proposed Amendments to Rule 17a-4 and Proposed Rule 18a-6

Section 764 of the Dodd-Frank Act added section 15F(f)(2) to the Exchange Act, which provides that the Commission shall adopt rules governing reporting and recordkeeping for SBSDs and MSBSPs.⁸⁸¹ Rule 17a-4 requires a broker-dealer to preserve certain records if it makes or receives them.⁸⁸² The Commission is proposing to amend this rule to account for the security-based swap and swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs. With respect to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, the Commission is proposing new Rule 18a-6 – which is modeled on Rule 17a-4, as proposed to be amended – to require these registrants to preserve certain records if they make or receive them.⁸⁸³ Proposed Rule 18a-6 would not include a parallel requirement for

⁸⁸¹ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10(f)(2).

⁸⁸² See 17 CFR 240.17a-4.

⁸⁸³ See proposed Rule 18a-6.

every requirement in Rule 17a-4 because some of the requirements in Rule 17a-4 relate to activities that are not expected or permitted of SBSDs and MSBSPs. In addition, the recordkeeping requirements for bank SBSDs and bank MSBSPs are tailored specifically to bank SBSD and bank MSBSP activities relating to operating as an SBSD or an MSBSP.

The proposed amendments to Rule 17a-4 and proposed Rule 18a-6 would establish a number of new collections of information, as summarized in the table below.

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	Non-model stand-alone SBSDs	ANC stand- alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
Records to be preserved for a period of not less than 6 years								
Trade blotters					18a-6(a)(1) citing 18a-5(a)(1)	18a-6(a)(1) citing 18a-5(a)(1)	18a-6(a)(2) citing 18a-5(b)(1)	18a-6(a)(1) citing 18a-5(a)(1)
General ledger					18a-6(a)(1) citing 18a-5(a)(2)	18a-6(a)(1) citing 18a-5(a)(2)		18a-6(a)(1) citing 18a-5(a)(2)
Ledgers for customer and non- customer accounts					18a-6(a)(1) citing 18a-5(a)(3)	18a-6(a)(1) citing 18a-5(a)(3)	18a-6(a)(2) citing 18a-5(b)(2)	18a-6(a)(1) citing 18a-5(a)(3)
Stock record					18a-6(a)(1) citing 18a-5(a)(4)	18a-6(a)(1) citing 18a-5(a)(4)	18a-6(a)(2) citing 18a-5(b)(3)	18a-6(a)(1) citing 18a-5(a)(4)
Records to be preserved for a period of not less than 3 years								
Memoranda of brokerage orders							18a-6 (b)(2)(i) citing 18a-6(b)(4)	
Memoranda of proprietary orders					18a-6 (b)(1)(i) citing 18a-6(a)(5)	18a-6 (b)(1)(i) citing 18a-6(a)(5)	18a-6 (b)(2)(i) citing 18a-6(b)(5)	18a-6 (b)(1)(i) citing 18a-6(a)(5)
Confirmations					18a-6 (b)(1)(i) citing 18a-6(a)(6)	18a-6 (b)(1)(i) citing 18a-6(a)(6)	18a-6 (b)(2)(i) citing 18a-6(b)(6)	18a-6 (b)(1)(i) citing 18a-6(a)(6)
Accountholder information					18a-6 (b)(1)(i) citing 18a-6(a)(7)	18a-6 (b)(1)(i) citing 18a-6(a)(7)	18a-6 (b)(2)(i) citing 18a-6(b)(7)	18a-6 (b)(1)(i) citing 18a-6(a)(7)
Options positions					18a-6 (b)(1)(i) citing 18a-6(a)(8)	18a-6 (b)(1)(i) citing 18a-6(a)(8)		18a-6 (b)(1)(i) citing 18a-6(a)(8)
Trial balances and computation of net capital	17a-4(b)(1) citing 17a-3(a)(11)	17a-4(b)(1) citing 17a-3(a)(11)	17a-4(b)(1) citing 17a-3(a)(11)	17a-4(b)(1) citing 17a-3(a)(11)	18a-6 (b)(1)(i) citing 18a-6(a)(9)	18a-6 (b)(1)(i) citing 18a-6(a)(9)		18a-6 (b)(1)(i) citing 18a-6(a)(9)
Liquidity stress test			17a-4(b)(1) citing 17a-3(a)(24)			18a-6 (b)(1)(i) citing		

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	Non-model stand-alone SBSDs	ANC stand- alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
						18a-6(a)(11)		
Account equity and margin calculations under proposed Rule 18a-3		17a-4(b)(1) citing 17a-3(a)(25)	17a-4(b)(1) citing 17a-3(a)(25)	17a-4(b)(1) citing 17a-3(a)(25)	18a-6 (b)(1)(i) citing 18a-6(a)(12)	18a-6 (b)(1)(i) citing 18a-6(a)(12)		18a-6 (b)(1)(i) citing 18a-6(a)(12)
Possession or control requirements under proposed Rule 18a-4		17a-4(b)(1) citing 17a-3(a)(26)	17a-4(b)(1) citing 17a-3(a)(26)		18a-6 (b)(1)(i) citing 18a-6(a)(13)	18a-6 (b)(1)(i) citing 18a-6(a)(13)	18a-6 (b)(2)(i) citing 18a-6(b)(9)	
Customer reserve requirements under proposed Rule 18a-4		17a-4(b)(1) citing 17a-3(a)(27)	17a-4(b)(1) citing 17a-3(a)(27)		18a-6 (b)(1)(i) citing 18a-6(a)(14)	18a-6 (b)(1)(i) citing 18a-6(a)(14)	18a-6 (b)(2)(i) citing 18a-6(b)(10)	
Unverified transactions		17a-4(b)(1) citing 17a-3(a)(28)	17a-4(b)(1) citing 17a-3(a)(28)	17a-4(b)(1) citing 17a-3(a)(28)	18a-6 (b)(1)(i) citing 18a-6(a)(15)	18a-6 (b)(1)(i) citing 18a-6(a)(15)	18a-6 (b)(2)(i) citing 18a-6(b)(11)	18a-6 (b)(1)(i) citing 18a-6(a)(15)
Political contributions		17a-4(b)(1) citing 17a-3(a)(29)	17a-4(b)(1) citing 17a-3(a)(29)		18a-6 (b)(1)(i) citing 18a-6(a)(16)	18a-6 (b)(1)(i) citing 18a-6(a)(16)	18a-6 (b)(2)(i) citing 18a-6(b)(12)	
Compliance with external business conduct requirements		17a-4(b)(1) citing 17a-3(a)(30)	17a-4(b)(1) citing 17a-3(a)(30)	17a-4(b)(1) citing 17a-3(a)(30)	18a-6 (b)(1)(i) citing 18a-6(a)(17)	18a-6 (b)(1)(i) citing 18a-6(a)(17)	18a-6 (b)(2)(i) citing 18a-6(b)(13)	18a-6 (b)(1)(i) citing 18a-6(a)(17)
Bank records					18a-6 (b)(1)(ii)	18a-6 (b)(1)(ii)		18a-6 (b)(1)(ii)
Bills					18a-6 (b)(1)(iii)	18a-6 (b)(1)(iii)		18a-6 (b)(1)(iii)
Communications	17a-4(b)(4)*	17a-4(b)(4)*	17a-4(b)(4)*	17a-4(b)(4)*	18a-6 (b)(1)(iv)	18a-6 (b)(1)(iv)	18a-6 (b)(2)(ii)	18a-6 (b)(1)(iv)
Trial balances					18a-6 (b)(1)(v)	18a-6 (b)(1)(v)		18a-6 (b)(1)(v)
Account documents					18a-6 (b)(1)(vi)	18a-6 (b)(1)(vi)	18a-6 (b)(2)(iii)	18a-6 (b)(1)(vi)
Written agreements	17a-4(b)(7)*	17a-4(b)(7)*	17a-4(b)(7)*	17a-4(b)(7)*	18a-6 (b)(1)(vii)	18a-6 (b)(1)(vii)	18a-6 (b)(2)(iv)	18a-6 (b)(1)(vii)
Information supporting financial reports	17a-4(b)(8)*	17a-4(b)(8)*	17a-4(b)(8)*	17a-4(b)(8)*	18a-6 (b)(1)(viii)	18a-6 (b)(1)(viii)	18a-6 (b)(2)(v)	18a-6 (b)(1)(viii)
Rule 15c3-4 risk management records (OTC derivatives dealers only)					18a-6 (b)(1)(ix)	18a-6 (b)(1)(ix)		18a-6 (b)(1)(ix)
Internal credit ratings						18a-6 (b)(1)(x)		
Regulation SBSR information	17a-4(b)(14)	17a-4(b)(14)	17a-4(b)(14)	17a-4(b)(14)	18a-6 (b)(1)(xi)	18a-6 (b)(1)(xi)	18a-6 (b)(2)(vi)	18a-6 (b)(1)(xi)
Records relating to business conduct standards		17a-4(b)(15)	17a-4(b)(15)	17a-4(b)(15)	18a-6 (b)(1)(xii)	18a-6 (b)(1)(xii)	18a-6 (b)(2)(vii)	18a-6 (b)(1)(xii)
Special entity documents		17a-4(b)(16)	17a-4(b)(16)	17a-4(b)(16)	18a-6 (b)(1)(xiii)	18a-6 (b)(1)(xiii)	18a-6 (b)(2)(viii)	18a-6 (b)(1)(xiii)

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	Non-model stand-alone SBSDs	ANC stand- alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
Associated person's employment application					18a-6(d)(1)	18a-6(d)(1)	18a-6(d)(1)	18a-6(d)(1)
Regulatory authority reports					18a-6(d)(2)(i)	18a-6(d)(2)(i)	18a-6(d)(2)(ii)	18a-6(d)(2)(i)
Compliance, supervisory, and procedures manuals					18a-6(d)(3)(i)	18a-6(d)(3)(i)	18a-6(d)(3)(ii)	18a-6(d)(3)(i)
Life of the enterprise and of any successor enterprise								
Corporate documents	17a-4(d)*	17a-4(d)*	17a-4(d)*	17a-4(d)*	18a-6(c)	18a-6(c)		18a-6(c)

* Broker-dealers are currently required to comply with these paragraphs of Rule 17a-4, but the Commission proposes to amend these paragraphs as required by the Dodd-Frank Act or to tailor to the types of records that should be preserved with respect to security-based swaps, and to make certain technical changes.

3. Proposed Amendments to Rule 17a-5 and Proposed Rule 18a-7

Section 764 of the Dodd-Frank Act added section 15F(f)(2) to the Exchange Act, which provides that the Commission shall adopt rules governing reporting for SBSDs and MSBSPs.⁸⁸⁴

Further, section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.⁸⁸⁵ The Commission has concurrent authority under section 17(a)(1) of the Exchange Act to prescribe reporting requirements for broker-dealers.⁸⁸⁶

Rule 17a-5 requires a broker-dealer to annually file reports audited by a PCAOB-registered independent public accountant, disclose certain financial information to customers, file with the Commission a statement about its engagement of an independent public accountant, notify the Commission of a change of accountant, and to notify the Commission of the change in fiscal year.⁸⁸⁷ The rule also requires the independent public accountant to notify the broker-

⁸⁸⁴ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10(f)(2).

⁸⁸⁵ See 15 U.S.C. 78o-10(f)(1)(A).

⁸⁸⁶ See 15 U.S.C. 78q(a)(1).

⁸⁸⁷ See 17 CFR 240.17a-5.

dealer if the accountant discovers an instance of non-compliance with certain broker-dealer rules or an instance of material weakness.⁸⁸⁸ Rule 17a-5 requires broker-dealers to file a financial report, compliance report, and/or exemption report with the Commission on an annual basis.⁸⁸⁹ ANC broker-dealers are required to file with the Commission additional information relating to market risk, credit risk, and the monthly liquidity stress test on a periodic basis.⁸⁹⁰

The Commission is proposing amendments to Rule 17a-5 to account for the security-based swap activities of broker-dealer SBSDs and broker-dealer MSBSPs.⁸⁹¹ Proposed Rule 18a-7 – which is modeled on Rule 17a-5, as proposed to be amended – would establish reporting requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs.⁸⁹² Under Rule 17a-5, as proposed to be amended, and proposed Rule 18a-7, SBSDs and MSBSPs would be required to periodically file proposed Form SBS.⁸⁹³ Broker-dealer SBSDs and broker-dealer MSBSPs would file Form SBS instead of the applicable part of Form X-17A-5.⁸⁹⁴ Form SBS would include additional entries as compared to Part II CSE of Form X-17A-5 to account for the firm's security-based swap activities.

⁸⁸⁸ See 17 CFR 240.17a-5(h).

⁸⁸⁹ See 17 CFR 240.17a-5(d).

⁸⁹⁰ See 17 CFR 240.17a-5(a)(5).

⁸⁹¹ See Rule 17a-5, as proposed to be amended. See also section II.B. of this release.

⁸⁹² See proposed Rule 18a-7.

⁸⁹³ See paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended; paragraphs (a)(1) and (2) of proposed Rule 18a-7. Nonbank SBSDs and nonbank MSBSPs would be required to file Form SBS on a monthly basis, whereas bank SBSDs and bank MSBSPs would be required to file Form SBS on a quarterly basis. Compare paragraphs (a)(1)(iv) of Rule 17a-5, as proposed to be amended, with paragraph (a)(1) of proposed Rule 18a-7, and paragraph (a)(2) of proposed Rule 18a-7.

⁸⁹⁴ As described above, a broker-dealer is required to file with the Commission or the broker-dealer's DEA a different part of Form X-17A-5 (Part II, Part IIA, Part IIB, or Part II CSE), depending on the nature of its business.

Proposed Rule 18a-7 does not include a parallel requirement for every requirement in Rule 17a-5.⁸⁹⁵ Moreover, instead of requiring stand-alone SBSDs and stand-alone MSBSPs to make available to customers an audited statement of financial condition with appropriate notes and certain reports of the independent public accountant, the Commission proposes that stand-alone SBSDs and stand-alone MSBSPs make such information available on their public website.⁸⁹⁶ Further, for the reasons discussed above, the reporting requirements in proposed Rule 18a-7, other than the requirement to periodically file proposed Form SBS, would not apply to bank SBSDs and bank MSBSPs.

4. Proposed Amendments to Rule 17a-11 and Proposed Rule 18a-8

Section 764 of the Dodd-Frank Act added section 15F(f)(2) to the Exchange Act, which provides that the Commission shall adopt rules governing reporting for SBSDs and MSBSPs.⁸⁹⁷ Section 15F(f)(1)(A) provides that SBSDs and MSBSPs shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the SBSD or MSBSP.⁸⁹⁸ In addition, the Commission has concurrent authority under section 17(a)(1) of the Exchange Act to prescribe reporting requirements for broker-dealers.⁸⁹⁹

Rule 17a-11 specifies the circumstances under which a broker-dealer must notify the Commission and other securities regulators about its financial or operational condition, as well as

⁸⁹⁵ For example, as described in further detail above, the Commission is not proposing a requirement in Rule 18a-7 that is parallel to the exemption report requirement in Rule 17a-5 or the requirement to file certain reports with SIPC. See 17 CFR 240.17a-5(d)(4) and (e)(4).

⁸⁹⁶ Compare 17 CFR 240.17a-5(c), with paragraph (b) of proposed Rule 18a-7.

⁸⁹⁷ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10(f)(2).

⁸⁹⁸ See 15 U.S.C. 78o-10(f)(1)(A).

⁸⁹⁹ See 15 U.S.C. 78q(a)(1).

the form that the notice must take.⁹⁰⁰ The Commission is proposing amendments to Rule 17a-11 to account for the security-based swap activities of broker-dealer SBSDs and broker-dealer MSBSPs.⁹⁰¹ Proposed Rule 18a-8 – which is modeled on Rule 17a-11, as proposed to be amended – would establish notification requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs.⁹⁰²

Proposed Rule 18a-8 would not include a parallel requirement for every requirement in Rule 17a-11 because some of the Rule 17a-11 notices relate to calculations that would not be relevant to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs.⁹⁰³ Further, the notification requirements for bank SBSDs and bank MSBSPs are designed to be tailored specifically to their activities as an SBSD or an MSBSP.

The proposed amendments to Rule 17a-11 and proposed Rule 18a-8 would establish a number of new collections of information, as summarized in the table below.

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	ANC stand-alone SBSDs	Non-model stand-alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
Net capital below minimum					18a-8 (a)(1)(i)	18a-8 (a)(1)(i)		
Tentative net capital below minimum					18a-8 (a)(1)(ii)			
Tangible net worth below minimum								18a-8 (a)(2)
Early warning of net capital					18a-8(b)(1)	18a-8(b)(1)		
Early warning of tentative net capital					18a-8 (b)(2)			
Early warning of tangible net worth				17a-11 (b)(6)				18a-8(b)(3)
Backtesting exception					18a-8(b)(4)			
Notice of adjustment of reported capital category							18a-8(c)	

⁹⁰⁰ See 17 CFR 240.17a-11.

⁹⁰¹ See paragraphs (b)(5), (e), and (f) of Rule 17a-11, as proposed to be amended.

⁹⁰² See proposed Rule 18a-8.

⁹⁰³ See, e.g., 17 CFR 240.17a-11(b)(2) and (c)(1).

	Non-SBSD/ MSBSP broker- dealers	Non-model broker- dealer SBSDs	ANC broker- dealer SBSDs	Broker- dealer MSBSPs	ANC stand-alone SBSDs	Non-model stand-alone SBSDs	Bank SBSDs	Stand-alone MSBSPs
Failure to make and keep current books and records					18a-8(d)	18a-8(d)	18a-8(d)	18a-8(d)
Material weakness					18a-8(e)	18a-8(e)		
Insufficient liquidity reserves			17a-11(e)		18a-8(f)			
Failure to make a required reserve deposit	17a-11(f)	17a-11(f)	17a-11(f)		18a-8(g)	18a-8(g)	18a-8(g)	

5. Proposed Rule 18a-9

Section 764 of the Dodd-Frank Act added section 15F(f)(2) to the Exchange Act, which provides that the Commission shall adopt rules governing reporting for SBSDs.⁹⁰⁴ In addition, section 15F(f)(2)(B)(ii) provides that nonbank SBSDs shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.⁹⁰⁵

Proposed Rule 18a-9, which is modeled on Rule 17a-13, would require stand-alone SBSDs to examine and count the securities they physically hold, account for the securities that are subject to their control or direction but are not in their physical possession, verify the locations of securities under certain circumstances, and compare the results of the count and verification with their records.⁹⁰⁶

B. Proposed Use of Information

Rule 17a-3, as proposed to be amended, and proposed Rule 18a-5 would require broker-dealers, SBSDs, and MSBSPs to make and keep current certain books and records. Rule 17a-4, as proposed to be amended, and proposed Rule 18a-6 would require broker-dealers, SBSDs, and

⁹⁰⁴ See Pub. L. 111-203, 764; 15 U.S.C. 78o-10(f)(2).

⁹⁰⁵ See 15 U.S.C. 78o-10(f)(1)(B)(ii).

⁹⁰⁶ Proposed Rule 18a-9 does not include the exceptions from applicability that Rule 17a-13 includes. See 17 CFR 240.17a-13(a) and (e).

MSBSPs to preserve certain records if the firm makes or receives the type of record. These rules are designed, among other things, to promote the prudent operation of broker-dealers, SBSDs, and MSBSPs and to assist the Commission, SROs, and state securities regulators in conducting effective examinations.⁹⁰⁷ Thus, the collections of information under the proposed amendments to Rules 17a-3 and 17a-4, and proposed Rules 18a-5 and 18a-6, would facilitate the examinations of broker-dealers, SBSDs, and MSBSPs.

Rule 17a-5, as proposed to be amended, and proposed Rule 18a-7 would establish reporting requirements for broker-dealers, SBSDs, and MSBSPs. Rule 17a-11, as proposed to be amended, and proposed Rule 18a-8 would require broker-dealers, SBSDs, and MSBSPs to notify the Commission of certain events related to their financial condition. The rules are designed to promote compliance with the proposed financial responsibility requirements for SBSDs and MSBSPs, facilitate regulators' oversight and examinations of such firms, and promote transparency of SBSDs' and MSBSPs' financial condition and operation.

Proposed Rule 18a-9 would require a stand-alone SBSD to physically examine, count and verify all securities positions (e.g., equities, corporate bonds, and government securities), and to compare the results of the count and verification with the firm's records at least once each calendar quarter. This proposed rule is designed to promote an SBSD's custody of securities and accurate accounting for securities.

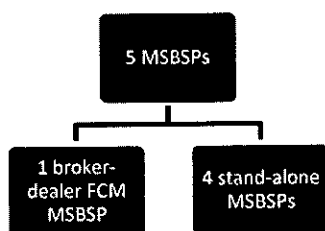
C. Respondents

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See, e.g., Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR at 55818 ("The Commission has required that broker-dealers create and maintain certain records so that, among other things, the Commission, [SROs], and State Securities Regulators . . . may conduct effective examinations of broker-dealers" (footnote omitted)).

Consistent with prior releases, the Commission estimates that fifty or fewer entities ultimately may be required to register with the Commission as SBSDs.⁹⁰⁸

In addition, consistent with prior releases, based on available data regarding the single-name credit default swap market – which the Commission believes will comprise the majority of security-based swaps – the Commission estimates that the number of MSBSPs likely will be five or fewer and, in actuality, may be zero.⁹⁰⁹ Therefore, to capture the likely number of MSBSPs that may be subject to the collections of information for purposes of this PRA, the Commission estimates for purposes of this PRA that five entities will register with the Commission as MSBSPs. Accordingly, for purposes of calculating PRA reporting burdens, the Commission estimates there will be fifty SBSDs and five MSBSPs.



Of the five MSBSPs, the Commission estimates that one firm also would be registered as a broker-dealer and an FCM.⁹¹⁰ By definition, an MSBSP's primary business is not engaging in security-based swap activity, so it would be rare for an MSBSP to qualify as a broker-dealer and/or FCM but not an SBS. Such an MSBSP would be engaged in the business of effecting

⁹⁰⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70292; Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR at 30725.

⁹⁰⁹ See id.

⁹¹⁰ See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65808.

securities transactions,⁹¹¹ but not in the business of effecting security-based swap transactions⁹¹² or commodities, securities futures products, or swaps⁹¹³ and yet involved in enough security-based swap transactions to be required to register as an MSBSP.⁹¹⁴ However, the Commission estimates there will be one broker-dealer FCM MSBSP for the purposes of calculating PRA burdens, in recognition that broker-dealer MSBSPs and stand-alone MSBSPs are subject to different burdens under the proposed and amended rules in certain instances.⁹¹⁵

The Commission previously estimated that sixteen broker-dealers would likely seek to register as SBSDs.⁹¹⁶ The Commission is retaining this estimate for purposes of this release. The Commission believes that all sixteen broker-dealer SBSDs also will be registered as FCMs, since SBSDs may find it beneficial to hedge security-based swap positions with futures contracts, options on futures, or swaps.⁹¹⁷ Accordingly, for purposes of calculating PRA reporting burdens, the Commission estimates there will be sixteen broker-dealer FCM SBSDs.

⁹¹¹ See 15 U.S.C. 78c(a)(4) (generally defining broker as any person engaged in the business of effecting transactions in securities for the account of others).

⁹¹² See 15 U.S.C. 78c(a)(71) (generally defining security-based swap dealer as any person who holds himself out as a dealer in security-based swaps, makes a market in security-based swaps, regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account, or engages in any other activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps).

⁹¹³ See 7 U.S.C. 1a(28) (generally defining futures commission merchant as a person engaged in soliciting or in accepting orders for the purchase or sale of a commodity for future delivery, a security futures product, or a swap).

⁹¹⁴ See 15 U.S.C. 78c(a)(67) (generally defining major security-based swap participant as any person who is not an SBSD but maintains a substantial position in security-based swaps for any of the major security-based swap categories, whose outstanding security-based swaps could have serious adverse effects on the financial stability of the U.S. banking system or financial markets, or is highly leveraged and maintains a substantial position in security-based swaps for any of the major security-based swap categories).

⁹¹⁵ The Commission believes that the broker-dealer MSBSP would register as an FCM, since the broker-dealer may find it beneficial to hedge security and security-based swap positions with futures contracts, options on futures, or swaps. See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65814.

⁹¹⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70292.

⁹¹⁷ See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65814.

For purposes of calculating PRA reporting burdens, the Commission estimates there would be twenty-five bank SBSDs and nine stand-alone SBSDs.⁹¹⁸ Because the Commission estimates that sixteen broker-dealers would likely register as SBSDs, there would be an estimated maximum of thirty-four non-broker-dealer SBSDs consisting of bank SBSDs and stand-alone SBSDs.⁹¹⁹ For business planning purposes, risk management purposes, potential regulatory requirements, and other reasons, some of these entities likely would register with the Commission as stand-alone SBSDs. Because many of the dealers that currently engage in OTC derivatives activities are banks, the Commission estimates that approximately 75% of the thirty-four non-broker-dealer SBSDs would register as bank SBSDs (*i.e.*, twenty-five firms),⁹²⁰ and the remaining 25% would register as stand-alone SBSDs (*i.e.*, nine firms).⁹²¹

The Commission believes that none of the bank SBSDs would register as FCMs, because of the burden associated with complying with three different supervisors' regulatory requirements.⁹²² However, the Commission believes that all of the stand-alone SBSDs would register as FCMs, since SBSDs may find it beneficial to hedge security-based swap positions with futures contracts, options on futures, or swaps.⁹²³

Of the nine stand-alone FCM SBSDs, the Commission estimates that, based on its experience with ANC broker-dealers and OTC derivatives dealers, the majority of stand-alone

⁹¹⁸ The Commission does not anticipate that any firms will be dually registered as a broker-dealer and a bank.

⁹¹⁹ 50 SBSDs – 16 broker-dealer SBSDs = 34 maximum non-broker-dealer SBSDs.

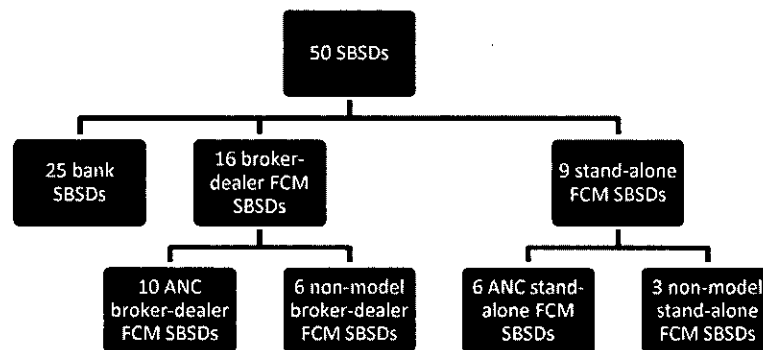
⁹²⁰ 34 maximum estimated non-broker-dealer SBSDs x 75% = 25.5, rounded to 25 bank SBSDs.

⁹²¹ 34 maximum estimated non-broker-dealer SBSDs x 25% = 8.5, rounded to 9 stand-alone FCM SBSDs.

⁹²² In addition, the Commission understands that banks do not register as FCMs; rather, bank affiliates register as FCMs.

⁹²³ See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65814.

SBSDs would apply to use internal models.⁹²⁴ Consequently, the Commission is estimating that six of the nine stand-alone SBSDs would apply to operate as ANC stand-alone SBSDs, which would use internal models to compute net capital under proposed Rule 18a-1. Because the Commission estimates that there would be six ANC stand-alone SBSDs, the Commission estimates that three stand-alone SBSDs would not use internal models to compute net capital.⁹²⁵



Of the sixteen broker-dealer FCM SBSDs, the Commission estimates that ten firms would operate as ANC broker-dealer SBSDs, which use internal models to compute net capital under Rule 15c3-1.⁹²⁶ Because the Commission estimates that ten broker-dealer SBSDs would be ANC broker-dealer SBSDs, it is estimated that six broker-dealer SBSDs would not use internal models to compute net capital.⁹²⁷

As of April 1, 2013, there were 4,545 broker-dealers registered with the Commission.

The Commission estimates that twenty-five registered broker-dealers will be engaged in

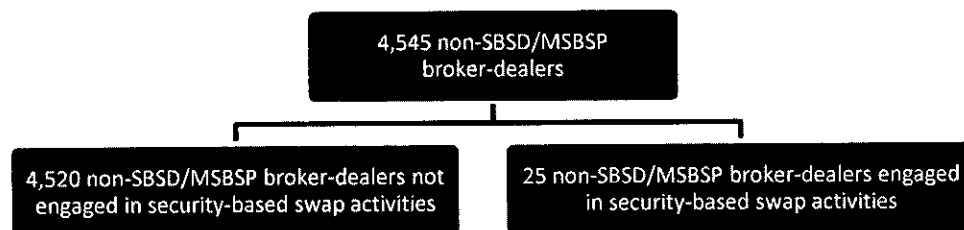
⁹²⁴ VaR models, while more risk-sensitive than standardized haircuts, tend to substantially reduce the amount of the deductions to tentative net capital in comparison to the standardized haircuts because the models recognize more offsets between related positions than the standardized haircuts. Therefore, the Commission expects that stand-alone SBSDs that have the capability to use internal models to calculate net capital would choose to do so.

⁹²⁵ 9 stand-alone FCM SBSDs – 6 ANC stand-alone FCM SBSDs = 3 non-model stand-alone FCM SBSDs.

⁹²⁶ Currently, 6 broker-dealers are registered as ANC broker-dealers and 1 broker-dealer's application to register as an ANC broker-dealer is pending. The Commission has previously estimated that all current and future ANC broker-dealers will also register as SBSDs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70293.

⁹²⁷ 16 broker-dealer FCM SBSDs – 10 ANC broker-dealer FCM SBSDs = 6 non-model broker-dealer FCM SBSDs.

security-based swap activities but would not be required to register as an SBSD or MSBSP. Other than OTC derivatives dealers, which are subject to significant limitations on their activities, broker-dealers historically have not participated in a significant way in security-based swap trading for at least two reasons.⁹²⁸ First, because the Exchange Act has not previously defined security-based swaps as “securities,” security-based swaps have not been required to be traded through registered broker-dealers.⁹²⁹ Second, a broker-dealer engaging in security-based swap activities is currently subject to existing regulatory requirements with respect to those activities, including capital, margin, segregation, and recordkeeping requirements. Specifically, the existing broker-dealer capital requirements make it relatively costly to conduct these activities in broker-dealers. As a result, security-based swap activities are mostly concentrated in affiliates of broker-dealers, not broker-dealers themselves.⁹³⁰



The Commission generally requests comment on all aspects of these estimates of the number of respondents. Commenters should provide specific data and analysis to support any comments they submit with respect to the number of respondents, including identifying any sources of industry information that could be used to estimate the number of respondents.

⁹²⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70302.

⁹²⁹ See Pub. L. 111-203, 761 (amending definition of “security” in 15 U.S.C. 78c(a)(10)).

⁹³⁰ See International Swaps and Derivatives Association (“ISDA”), Margin Survey 2012 (May 1, 2012) (“ISDA Margin Survey 2012”), at Appendix 1, available at <http://www2.isda.org/attachment/NDM5MQ=/ISDA%20Margin%20Survey%202012%20FORMATTED.pdf>. The ISDA Margin Survey is conducted annually to examine the state of collateral use and management among derivatives dealers and end-users. Appendix 1 to the survey lists firms that responded to the survey including broker-dealers. See *id.*

D. Total Initial And Annual Recordkeeping And Reporting Burden

1. Proposed Amendments to Rule 17a-3 and Proposed Rule 18a-5

The proposed amendments to Rule 17a-3 and proposed Rule 18a-5 would impose collection of information requirements that result in initial and annual time burdens for broker-dealers, SBSDs, and MSBSPs. Current Rule 17a-3 imposes an estimated annual burden of 539 hours per firm and \$8,256 in costs and a total industry burden of 2,449,755 hours and \$37,523,520 in costs.⁹³¹ The Commission estimates that the proposed amendments to Rule 17a-3 would impose the following initial and annual burdens:

Burden	Initial Burden	Annual Burden
New security-based swap records ⁹³²	<i>Per firm:</i> 30 hours <i>Industry:</i> 1,260 hours	<i>Per firm:</i> 42 hours <i>Industry:</i> 1,764 hours
New burdens applicable to broker-dealer SBSDs and broker-dealer MSBSPs ⁹³³	<i>Per firm:</i> 60 hours <i>Industry:</i> 1,020 hours	<i>Per firm:</i> 75 hours <i>Industry:</i> 1,275 hours
New burdens applicable to broker-dealer SBSDs ⁹³⁴	<i>Per firm:</i> 60 hours <i>Industry:</i> 960 hours	<i>Per firm:</i> 75 hours <i>Industry:</i> 1,200 hours
New burdens applicable to ANC broker-dealers ⁹³⁵	<i>Per firm:</i> 20 hours <i>Industry:</i> 200 hours	<i>Per firm:</i> 25 hours <i>Industry:</i> 250 hours
Total – Proposed amendments to Rule 17a-3	<i>Industry:</i> 3,440 hours	<i>Industry:</i> 4,489 hours

The Commission estimates that proposed Rule 18a-5 would impose the following initial and annual burdens:

Burden	Initial Burden	Annual Burden
Burdens applicable to stand-alone SBSDs and stand-alone MSBSPs ⁹³⁶	<i>Per firm:</i> 260 hours and \$1,000 <i>Industry:</i> 3,380 hours and \$13,000	<i>Per firm:</i> 325 hours and \$4,650 <i>Industry:</i> 4,225 hours and \$60,450
Burdens applicable to stand-alone SBSDs ⁹³⁷	<i>Per firm:</i> 60 hours <i>Industry:</i> 540 hours	<i>Per firm:</i> 75 hours <i>Industry:</i> 675 hours

⁹³¹ See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3 (Mar. 28, 2011), available at <http://www.reginfo.gov/public/do/DownloadDocument?documentID=238297&version=1>.

⁹³² See paragraphs (a)(1), (a)(3), (a)(5)(ii), (a)(6)(ii), (a)(7)(ii), (a)(8)(ii), and (a)(9)(iv) of Rule 17a-3, as proposed to be amended.

⁹³³ See paragraphs (a)(25), (a)(28), and (a)(30) of Rule 17a-3, as proposed to be amended.

⁹³⁴ See paragraphs (a)(26), (a)(27), and (a)(29) of Rule 17a-3, as proposed to be amended.

⁹³⁵ See paragraph (a)(24) of Rule 17a-3, as proposed to be amended.

⁹³⁶ See paragraphs (a)(1) through (a)(10), (a)(12), (a)(15), and (a)(17) of proposed Rule 18a-5.

Burdens applicable to ANC stand-alone SBSDs ⁹³⁸	<i>Per firm:</i> 20 hours <i>Industry:</i> 120 hours	<i>Per firm:</i> 25 hours <i>Industry:</i> 150 hours
Burdens applicable to bank SBSDs and bank MSBSPs ⁹³⁹	<i>Per firm:</i> 200 hours <i>Industry:</i> 5,000 hours	<i>Per firm:</i> 250 hours <i>Industry:</i> 6,250 hours
Burdens applicable to bank SBSDs ⁹⁴⁰	<i>Per firm:</i> 60 hours <i>Industry:</i> 1,500 hours	<i>Per firm:</i> 75 hours <i>Industry:</i> 1,875 hours
Total – Proposed Rule 18a-5	<i>Industry:</i> 10,540 hours and \$13,000	<i>Industry:</i> 13,175 hours and \$60,450

Estimated Ongoing Hours and Costs of Current Rule 17a-3

In the Supporting Statement accompanying the most recent extension of Rule 17a-3's collection, the estimated ongoing burden for a registered broker-dealer to make and keep current the books and records required by Rule 17a-3 averages out to 539 hours per year and \$8,256 per year (after adjusting for increases in postage prices), although actual recordkeeping requirements vary depending on the broker-dealer's size and complexity.⁹⁴¹ Given that 4,545 broker-dealers were registered with the Commission as of April 1, 2013, current Rule 17a-3 creates an estimated industry-wide ongoing annual burden of 2,449,755 hours⁹⁴² and \$37,523,520.⁹⁴³

Estimated Hours and Costs of Proposed Amendments to Rule 17a-3

Many of the proposed amendments to Rule 17a-3 are not expected to impose an initial burden. Most of the additional proposed amendments discussed in section II.A.2.b. of this release are largely clarifying changes that should not impose an hour burden or costs. With respect to the proposed new records required by the proposed amendments to Rule 17a-3, these

⁹³⁷ See paragraphs (a)(13), (a)(14), and (a)(16) of proposed Rule 18a-5.

⁹³⁸ See paragraph (a)(11) of proposed Rule 18a-5.

⁹³⁹ See paragraphs (b)(1) through (b)(8), (b)(11), and (b)(13) of proposed Rule 18a-5.

⁹⁴⁰ See paragraphs (b)(9), (b)(10), and (b)(12) of proposed Rule 18a-5.

⁹⁴¹ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3 at 9 (2,723,970 hours/year / 5,057 registered broker-dealers = 539 hours/year per registered broker-dealer).

⁹⁴² 539 hours/year x 4,545 registered broker-dealers = 2,449,755 hours/year.

⁹⁴³ \$8,256/year x 4,545 registered broker-dealers = \$37,523,520/year.

are not expected to impose initial dollar costs because firms should already own or have established the requisite recordkeeping system software. Firms will likely need to program software to begin collecting additional records and may need to update their compliance manuals to reflect that certain paragraphs of Rule 17a-3 have been proposed to be re-numbered. The Commission expects these services to be performed in-house, and these hourly burdens are estimated below.

The Commission does not expect there to be a burden associated with its proposal to modify the definition of securities regulatory authority to include the CFTC and prudential regulators to the extent they oversee security-based swap activities, because the Commission does not expect any broker-dealers to dually register as banks and estimates that thirty-four broker-dealers would be dually registered as FCMs,⁹⁴⁴ swap dealers, and/or major swap participants.⁹⁴⁵ In the three instances that securities regulatory authority is mentioned, the broker-dealer must provide certain information to its securities regulatory authority if the firm does not make the required record or memorandum containing the information and the information is requested by the securities regulatory authority.⁹⁴⁶ The Commission understands that it is already industry practice to make the required record and memorandum of the information in these three instances (especially among more sophisticated entities dually registered with the Commission and the CFTC), and therefore the Commission does not believe that this proposed amendment would impose an additional burden.

⁹⁴⁴ The Commission estimates that 34 broker-dealers are dually registered as FCMs – 17 non-SBSD/MSBSP broker-dealers, 16 broker-dealer SBSDs, and 1 broker-dealer MSBSP. As of March 31, 2013, 34 broker-dealers reported a positive value on Line Item 7060 of the FOCUS Report (amount required to be segregated under CFTC rules), which is a line item that is only filled in by FCMs.

⁹⁴⁵ The Commission estimates that all 17 estimated broker-dealer FCM SBSDs and broker-dealer FCM MSBSPs would also register as swap dealers or major swap participants. See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 65814 (estimating that 35 SBSDs or MSBSPs would also be registered with the CFTC as swap dealers or major swap participants).

⁹⁴⁶ See paragraphs (a)(6)(i), (a)(7)(i), and (a)(19)(i) of Rule 17a-3, as proposed to be amended.

The Commission proposes to eliminate three exemptions from Rule 17a-3 which should not affect the burden of complying with Rule 17a-3. Paragraph (b)(2) exempts transactions cleared by a bank if the bank keeps the requisite records for the broker-dealer,⁹⁴⁷ but the Commission believes that this exemption is not relied on. Paragraph (c) exempts records of certain U.S. bond sales⁹⁴⁸ and paragraph (d) exempts records of certain *de minimis* cash transactions,⁹⁴⁹ but the Commission believes these transactions are currently automatically recorded as a matter of practice because it likely takes more time to identify these transactions as exempt than to make and keep records of these transactions.

The Commission proposes to amend paragraphs (a)(1), (a)(3), (a)(5), (a)(6), (a)(7), (a)(8), and (a)(9) of Rule 17a-3 to include a provision requiring broker-dealers to make and keep current various records for security-based swaps.⁹⁵⁰ The Commission estimates that the proposed amendments to paragraphs (a)(1), (a)(3), (a)(5), (a)(6), (a)(7), (a)(8), and (a)(9) of Rule 17a-3 would impose on each broker-dealer that engages in security-based swap activities an initial burden of thirty hours and an ongoing burden of approximately ten minutes per business day, or forty-two hours per year.⁹⁵¹ The Commission estimates that there are forty-two respondents – sixteen broker-dealer SBSs, one broker-dealer MSBS, and twenty-five non-SBS/MSBS

⁹⁴⁷ See 17 CFR 240.17a-3(b)(2).

⁹⁴⁸ See 17 CFR 240.17a-3(c).

⁹⁴⁹ See 17 CFR 240.17a-3(d).

⁹⁵⁰ The provision for securities other than security-based swaps would largely mirror the paragraph's current text. See paragraphs (a)(1), (a)(3), (a)(5)(i), (a)(6)(i), (a)(7)(i), (a)(8)(i), and (a)(9)(i) through (iii) of Rule 17a-3, as proposed to be amended. The provision for security-based swaps would tailor to security-based swaps the type of records the broker-dealer must make and keep current. See paragraphs (a)(1), (a)(3), (a)(5)(ii), (a)(6)(ii), (a)(7)(ii), (a)(8)(ii), and (a)(9)(iv) of Rule 17a-3, as proposed to be amended.

⁹⁵¹ (10 minutes/business day / 60 minutes/hour) x 251 business days/year = 42 hours/year. There are 251 non-weekend days in 2013. The Commission does not include U.S. public holidays in estimating the number of business days per year, given that many broker-dealers trading security-based swaps operate internationally.

broker-dealers engaged in security-based swap activities.⁹⁵² Thus, these proposed amendments would add to the industry an estimated initial burden of 1,260 hours⁹⁵³ and an ongoing burden of 1,764 hours per year.⁹⁵⁴

The proposed amendments to Rule 17a-3 would require three additional types of records to be made and kept current by broker-dealer SBSs and broker-dealer MSBSs.⁹⁵⁵ Because the burden to run the applicable calculation or comply with the applicable standard is accounted for in the PRA estimates for proposed Rules 18a-3,⁹⁵⁶ 15Fi-1,⁹⁵⁷ 15Fh-1 through 15Fh-5, and 15Fk-1,⁹⁵⁸ the burden imposed by these new requirements is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraphs (a)(25), (a)(28), and (a)(30) of Rule 17a-3, as proposed to be amended, would impose an initial burden of 60 hours per firm and an ongoing annual burden of seventy-five hours per firm. The Commission estimates that there are seventeen respondents (sixteen broker-dealer SBSs and

⁹⁵² 16 broker-dealer SBSs + 1 broker-dealer MSBS + 25 non-SBS/MSBS broker-dealers engaged in security-based swap activities = 42 broker-dealers engaged in security-based swap activities.

⁹⁵³ 30 hours/year x 42 broker-dealers engaged in security-based swap activities = 1,260 hours/year. These internal hours likely would be performed by a compliance manager.

⁹⁵⁴ 42 hours/year x 42 broker-dealers engaged in security-based swap activities = 1,764 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁵⁵ See paragraphs (a)(25), (a)(28), and (a)(30) of Rule 17a-3, as proposed to be amended (proposing recordkeeping requirements for Rule 18a-3 calculations, unverified transactions, and compliance with external business conduct requirements, respectively).

⁹⁵⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297.

⁹⁵⁷ See Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 FR at 3869–3870.

⁹⁵⁸ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42443–42448.

one broker-dealer MSBSP), adding to the industry an initial burden of 1,020 hours⁹⁵⁹ and an ongoing burden of 1,275 hours per year.⁹⁶⁰

The proposed amendments to Rule 17a-3 would require three additional types of records to be made and kept current by broker-dealer SBSDs.⁹⁶¹ Because the burden to run the applicable calculation or comply with the applicable standard is accounted for in the PRA estimates for proposed Rules 18a-4⁹⁶² and 15Fh-6,⁹⁶³ the burden imposed by these new requirements is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraphs (a)(26), (a)(27), and (a)(29) of Rule 17a-3, as proposed to be amended, would impose an initial burden of sixty hours per firm and an ongoing annual burden of seventy-five hours per firm. The Commission estimates that there are sixteen broker-dealer SBSDs, adding to the industry an initial burden of 960 hours⁹⁶⁴ and an ongoing burden of 1,200 hours per year.⁹⁶⁵

The Commission proposes to add paragraph (a)(24) to Rule 17a-3, which would require ANC broker-dealers to make and keep current certain records relating to the firm's monthly

⁹⁵⁹ 60 hours x 17 broker-dealer SBSDs and broker-dealer MSBSPs = 1,020 hours. These internal hours likely would be performed by a compliance manager.

⁹⁶⁰ 75 hours/year x 17 broker-dealer SBSDs and broker-dealer MSBSPs = 1,275 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁶¹ See Rule 17a-3, as proposed to be amended (paragraph (a)(26) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(27) (proposed Rule 18a-4 reserve account computations); and paragraph (a)(29) (political contributions)).

⁹⁶² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

⁹⁶³ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42447.

⁹⁶⁴ 60 hours x 16 broker-dealer SBSDs = 960 hours. These internal hours likely would be performed by a compliance manager.

⁹⁶⁵ 75 hours/year x 16 broker-dealer SBSDs = 1,200 hours/year. These internal hours likely would be performed by a compliance clerk.

liquidity stress test.⁹⁶⁶ Because the burden of actually performing the liquidity stress test and creating a liquidity funding plan is already accounted for in the PRA estimate for Rule 15c3-1, as proposed to be amended,⁹⁶⁷ the burden imposed by paragraph (a)(24) of Rule 17a-3, as proposed to be amended, is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraph (a)(24) would impose on each ANC broker-dealer an initial burden of twenty hours and an ongoing burden of twenty-five hours per year. The Commission estimates that there are ten ANC broker-dealers (all of which are assumed to be dually registered as SBSBs), adding to the industry an initial burden of 200 hours⁹⁶⁸ and an ongoing burden of 250 hours per year.⁹⁶⁹

Estimated Hours and Costs of Proposed Rule 18a-5

Dollar Costs. The Commission estimates that proposed Rule 18a-5 would cause a stand-alone SBSB or stand-alone MSBSP to incur an initial dollar cost of approximately \$1,000 to purchase recordkeeping system software and an ongoing dollar cost of \$4,650 per year for associated equipment and systems development. The Commission estimates that there are thirteen respondents (nine stand-alone SBSBs and four stand-alone MSBSPs), resulting in an estimated industry-wide initial burden of \$13,000⁹⁷⁰ and an industry-wide ongoing burden of \$60,450 per year.⁹⁷¹

⁹⁶⁶ See paragraph (a)(24) of Rule 17a-3, as proposed to be amended.

⁹⁶⁷ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70294.

⁹⁶⁸ 20 hours x 10 ANC broker-dealers = 200 hours. These internal hours likely would be performed by a compliance manager.

⁹⁶⁹ 25 hours/year x 10 ANC broker-dealers = 250 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁷⁰ \$1,000 x 13 stand-alone SBSBs and stand-alone MSBSPs = \$13,000.

⁹⁷¹ \$4,650/year x 13 stand-alone SBSBs and stand-alone MSBSPs = \$60,450/year.

Proposed Rule 18a-5 is not expected to increase the initial and ongoing dollar costs that bank SBSDs and bank MSBSPs incur to purchase recordkeeping system software and for equipment and systems development. Banks are already subject to recordkeeping requirements by the prudential regulators,⁹⁷² so they already own or have established the requisite recordkeeping system software. Although bank SBSDs and bank MSBSPs may need to program the software to begin collecting additional records, the Commission expects these services to be performed in-house, and these hour burdens are estimated below.

Hour Burden. Proposed Rule 18a-5 would require thirteen types of records to be made and kept current by stand-alone SBSDs and stand-alone MSBSPs.⁹⁷³ Proposed Rule 18a-5 imposes the burden to make and keep current these records, but does not require the firm to perform the underlying task.⁹⁷⁴ Therefore, after consideration of the estimated burdens under Rule 17a-3, as proposed to be amended, the Commission estimates that paragraphs (a)(1) through (a)(10), (a)(12), (a)(15), and (a)(17) of proposed Rule 18a-5 would impose on each firm an initial burden of 260 hours and an ongoing annual burden of 325 hours. The Commission estimates that there are thirteen respondents (nine stand-alone SBSDs and four stand-alone

⁹⁷² See, e.g., 12 CFR 12.3 (Department of Treasury); 12 CFR 219.21 *et seq.* (Federal Reserve); 12 CFR 344.4 (FDIC).

⁹⁷³ See proposed Rule 18a-5 (paragraph (a)(1) (trade blotters); paragraph (a)(2) (general ledgers); paragraph (a)(3) (ledgers of customer and non-customer accounts); paragraph (a)(4) (stock record); paragraph (a)(5) (memoranda of proprietary orders); paragraph (a)(6) (confirmations); paragraph (a)(7) (accountholder information); paragraph (a)(8) (options positions); paragraph (a)(9) (trial balances and computation of net capital); paragraph (a)(10) (associated person's application); paragraph (a)(12) (proposed Rule 18a-3 calculations); paragraph (a)(15) (unverified transactions); paragraph (a)(17) (compliance with external business conduct standards)).

⁹⁷⁴ In estimating the burden associated with proposed Rules 18a-5 and 18a-6, the Commission recognizes that entities that would register stand-alone SBSDs and stand-alone MSBSPs likely make and keep some records today as a matter of routine business practice, but the Commission does not have information about the records that such entities currently keep. Therefore, the Commission is estimating the PRA burden for these entities based on the assumption that they currently keep no records.

MSBSPs), resulting in an estimated industry-wide initial burden of 3,380 hours⁹⁷⁵ and an industry-wide ongoing annual burden of 4,225 hours.⁹⁷⁶

Proposed Rule 18a-5 would require three types of records to be made and kept current by stand-alone SBSDs.⁹⁷⁷ Because the burden to run the applicable calculation or comply with the applicable standard is accounted for in the PRA estimates for proposed Rules 18a-4⁹⁷⁸ and 15Fh-6,⁹⁷⁹ the burden imposed by these new requirements is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraphs (a)(13), (a)(14), and (a)(16) of proposed Rule 18a-5 would impose an initial burden of sixty hours per firm and an ongoing annual burden of seventy-five hours per firm. The Commission estimates that there are nine stand-alone SBSDs, resulting in an industry-wide initial burden of 540 hours⁹⁸⁰ and an industry-wide ongoing burden of 675 hours per year.⁹⁸¹

Paragraph (a)(11) of proposed Rule 18a-5 would require ANC stand-alone SBSDs to make and keep current certain records relating to the monthly liquidity stress test.⁹⁸² Because the burden of actually performing the liquidity stress test and creating a liquidity funding plan is

⁹⁷⁵ 260 hours x 13 stand-alone SBSDs and stand-alone MSBSPs = 3,380 hours. These internal hours likely would be performed by a compliance manager.

⁹⁷⁶ 325 hours/year x 13 stand-alone SBSDs and stand-alone MSBSPs = 4,225 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁷⁷ See proposed Rule 18a-5 (paragraph (a)(13) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(14) (proposed Rule 18a-4 reserve account computations); and paragraph (a)(16) (political contributions)).

⁹⁷⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

⁹⁷⁹ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42447.

⁹⁸⁰ 60 hours x 9 stand-alone SBSDs = 540 hours. These internal hours likely would be performed by a compliance manager.

⁹⁸¹ 75 hours/year x 9 stand-alone SBSDs = 675 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁸² See paragraph (a)(11) of proposed Rule 18a-5.

already accounted for in the PRA estimate for proposed Rule 18a-1,⁹⁸³ the burden imposed by paragraph (a)(11) of proposed Rule 18a-5 is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraph (a)(11) would impose on each ANC broker-dealer an initial burden of twenty hours and an ongoing burden of twenty-five hours per year. The Commission estimates that there are six ANC stand-alone SBSBs, resulting in an industry-wide initial burden of 120 hours⁹⁸⁴ and an industry-wide ongoing burden of 150 hours per year.⁹⁸⁵

Proposed Rule 18a-5 would require ten types of records to be made and kept current by bank SBSBs and bank MSBSs, all of which are limited to the firm's business as an SBSB or MSBS.⁹⁸⁶ Proposed Rule 18a-5 imposes the burden to make and keep current these records, but does not require the firm to perform the underlying task. Therefore, after consideration of the estimated burdens under Rule 17a-3, as proposed to be amended, the Commission estimates that paragraphs (b)(1) through (b)(8), (b)(11), and (b)(13) of proposed Rule 18a-5 would impose on each firm an initial burden of 200 hours per firm and an ongoing burden of 250 hours per firm. The Commission estimates that there are twenty-five respondents (twenty-five bank

⁹⁸³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70294.

⁹⁸⁴ 20 hours x 6 ANC stand-alone SBSBs = 120 hours. These internal hours likely would be performed by a compliance manager.

⁹⁸⁵ 25 hours/year x 6 ANC stand-alone SBSBs = 150 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁸⁶ See proposed Rule 18a-5 (paragraph (b)(1) (trade blotters); paragraph (b)(2) (general ledgers); paragraph (b)(3) (stock record); paragraph (b)(4) (memoranda of brokerage orders); paragraph (b)(5) (memoranda of proprietary orders); paragraph (b)(6) (confirmations); paragraph (b)(7) (account holder information); paragraph (b)(8) (associated person's application); paragraph (b)(11) (unverified transactions); and paragraph (b)(13) (compliance with external business conduct requirements)).

SBSDs and no bank MSBSPs), resulting in an estimated industry-wide initial burden of 5,000 hours⁹⁸⁷ and an industry-wide ongoing burden of 6,250 hours per year.⁹⁸⁸

Proposed Rule 18a-5 would require three types of records to be made and kept current by bank SBSBs, all of which are limited to the firm's business as an SBSB.⁹⁸⁹ Because the burden to run the applicable calculation or comply with the applicable standard is accounted for in the PRA estimates for proposed Rules 18a-4⁹⁹⁰ and 15Fh-6,⁹⁹¹ the burden imposed by these new requirements is the requirement to make and keep current a written record of these tasks. The Commission estimates that paragraphs (b)(9), (b)(10), and (b)(12) of proposed Rule 18a-5 would impose an initial burden of sixty hours per firm and an ongoing annual burden of seventy-five hours per firm. The Commission estimates that there are twenty-five bank SBSBs, resulting in an industry-wide initial burden of 1,500 hours⁹⁹² and an industry-wide ongoing burden of 1,875 hours per year.⁹⁹³

2. Proposed Amendments to Rule 17a-4 and Proposed Rule 18a-6

The proposed amendments to Rule 17a-4 and proposed Rule 18a-6 would impose collection of information requirements that result in initial and ongoing burdens for broker-

⁹⁸⁷ 200 hours x 25 bank SBSBs = 5,000 hours. These internal hours likely would be performed by a compliance manager.

⁹⁸⁸ 250 hours/year x 25 bank SBSBs = 6,250 hours/year. These internal hours likely would be performed by a compliance clerk.

⁹⁸⁹ See proposed Rule 18a-5 (paragraph (b)(9) (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (b)(10) (proposed Rule 18a-4 reserve account computations); and paragraph (b)(12) (political contributions)).

⁹⁹⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

⁹⁹¹ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42447.

⁹⁹² 60 hours x 25 bank SBSBs = 1,500 hours. These internal hours likely would be performed by a compliance manager.

⁹⁹³ 75 hours/year x 25 bank SBSBs = 1,875 hours/year. These internal hours likely would be performed by a compliance clerk.

dealers, SBSBs, MSBSPs, and certain third-party custodians. Current Rule 17a-4 imposes an estimated annual burden of 254 hours per firm and \$5,000 and a total industry burden of 1,196,086 hours and \$23,545,000.⁹⁹⁴ The Commission estimates that the proposed amendments to Rule 17a-4 would impose the following initial and annual burdens:

Burden	Initial Burden	Annual Burden
Recorded telephone calls ⁹⁹⁵	<i>Per firm:</i> 13 hours <i>Industry:</i> 221 hours	<i>Per firm:</i> 6 hours and \$2,000 <i>Industry:</i> 102 hours and \$34,000
New burdens applicable to all broker-dealers ⁹⁹⁶	<i>Per firm:</i> 39 hours <i>Industry:</i> 1,638 hours	<i>Per firm:</i> 18 hours and \$360 <i>Industry:</i> 756 hours and \$15,120
New burdens applicable to broker-dealer SBSBs and broker-dealer MSBSPs ⁹⁹⁷	<i>Per firm:</i> 65 hours <i>Industry:</i> 1,105 hours	<i>Per firm:</i> 30 hours and \$600 <i>Industry:</i> 510 hours and \$10,200
New burdens applicable to broker-dealer SBSBs ⁹⁹⁸	<i>Per firm:</i> 39 hours <i>Industry:</i> 624 hours	<i>Per firm:</i> 18 hours and \$360 <i>Industry:</i> 288 hours and \$5,760
New burdens applicable to ANC broker-dealers ⁹⁹⁹	<i>Per firm:</i> 13 hours <i>Industry:</i> 130 hours	<i>Per firm:</i> 6 hours and \$120 <i>Industry:</i> 60 hours and \$1,200
Total – Proposed amendments to Rule 17a-4	<i>Industry:</i> 3,718 hours	<i>Industry:</i> 1,716 hours and \$66,280

The Commission estimates that proposed Rule 18a-6 would impose the following initial and annual burdens:

Burden	Initial Burden	Annual Burden
Burdens applicable to stand-alone SBSBs and stand-alone MSBSPs ¹⁰⁰⁰	<i>Per firm:</i> 364 hours <i>Industry:</i> 4,732 hours	<i>Per firm:</i> 280 hours and \$5,720 <i>Industry:</i> 3,640 hours and \$74,360
Burdens applicable to stand-alone SBSBs ¹⁰⁰¹	<i>Per firm:</i> 44 hours <i>Industry:</i> 396 hours	<i>Per firm:</i> 30 hours and \$360 <i>Industry:</i> 270 hours and \$3,240
Burdens applicable to ANC stand-alone SBSBs ¹⁰⁰²	<i>Per firm:</i> 31 hours <i>Industry:</i> 186 hours	<i>Per firm:</i> 20 hours and \$240 <i>Industry:</i> 120 hours and \$1,440

⁹⁹⁴ See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-4 (Sept. 12, 2013), available at <http://www.reginfo.gov/public/do/DownloadDocument?documentID=422180&version=0>.

⁹⁹⁵ See paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

⁹⁹⁶ See paragraphs (b)(1), (b)(8)(v) through (viii), (b)(8)(xvi), and (b)(14) of Rule 17a-4, as proposed to be amended.

⁹⁹⁷ See paragraphs (b)(1), (b)(15), and (b)(16) of Rule 17a-4, as proposed to be amended.

⁹⁹⁸ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended.

⁹⁹⁹ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended.

¹⁰⁰⁰ See paragraphs (a)(1), (b)(1)(i) through (ix), (b)(1)(xi) through (xiii), (c), (d)(1), (d)(2)(i), and (d)(3)(i) of proposed Rule 18a-6.

¹⁰⁰¹ See paragraph (b)(1)(i) of proposed Rule 18a-6.

Burdens applicable to bank SBSDs and bank MSBSPs ¹⁰⁰³	<i>Per firm:</i> 247 hours <i>Industry:</i> 6,175 hours	<i>Per firm:</i> 190 hours and \$4,520 <i>Industry:</i> 4,750 hours and \$113,000
Burdens applicable to bank SBSDs ¹⁰⁰⁴	<i>Per firm:</i> 57 hours <i>Industry:</i> 1,425 hours	<i>Per firm:</i> 40 hours and \$480 <i>Industry:</i> 1,000 hours and \$12,000
Burdens applicable to third-party custodians ¹⁰⁰⁵	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 2 hours <i>Industry:</i> 38 hours
Total – Proposed Rule 18a-6	<i>Industry:</i> 12,914 hours	<i>Industry:</i> 9,818 hours and \$204,078

Estimated Ongoing Hours and Costs of Current Rule 17a-4

The Supporting Statement accompanying the most recent extension of Rule 17a-4's collection estimates that each registered broker-dealer spends 254 hours to ensure it is in compliance with Rule 17a-4 and produce records promptly when required, and \$5,000 each year on physical space and computer hardware and software to store the requisite documents and information.¹⁰⁰⁶ Given that 4,545 broker-dealers were registered with the Commission as of April 1, 2013, current Rule 17a-4 creates an estimated industry-wide ongoing annual cost of 1,154,430 hours¹⁰⁰⁷ and \$22,725,000.¹⁰⁰⁸

Estimated Hours and Costs of Proposed Amendments to Rule 17a-4

Many of the proposed amendments to Rule 17a-4 are not expected to change the estimated burden imposed by Rule 17a-4. Most of the additional proposed amendments discussed in section II.A.3.b. of this release are largely clarifying changes that do not affect the Commission's burden estimate. Similarly, paragraph (m)(5) of Rule 17a-4, as proposed to be

¹⁰⁰² See paragraphs (b)(1)(i) and (b)(1)(x) of proposed Rule 18a-6.

¹⁰⁰³ See paragraphs (a)(2), (b)(2)(i) through (iv), (b)(2)(vi) through (viii), (d)(1), (d)(2)(ii), and (d)(3)(ii) of proposed Rule 18a-6.

¹⁰⁰⁴ See paragraphs (b)(2)(i) and (b)(2)(v) of proposed Rule 18a-6.

¹⁰⁰⁵ See paragraph (f) of proposed Rule 18a-6.

¹⁰⁰⁶ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-4.

¹⁰⁰⁷ 254 hours/year x 4,545 registered broker-dealers = 1,154,430 hours/year.

¹⁰⁰⁸ \$5,000/year x 4,545 registered broker-dealers = \$22,725,000/year.

amended, which adds a definition for business as such,¹⁰⁰⁹ is a clarifying amendment that should not affect the rule's burden.

The Commission believes there is no burden associated with its proposal that a broker-dealer retain a record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of aggregate indebtedness and net capital.¹⁰¹⁰ Since Rule 17a-3 requires broker-dealers to make these records, the Commission understands that it is already industry practice for broker-dealers to also keep these records. In addition, Rule 17a-4 already requires broker-dealers to keep records containing substantially similar information,¹⁰¹¹ so that the same record would likely also include the information required by this proposed amendment to Rule 17a-4.

The Commission believes there is no burden associated with its proposal that a security-based swap customer or non-customer's written agreements be maintained with his or her account records,¹⁰¹² because the Commission understands that it is already industry practice to keep written agreements with the relevant person's account records.

Certain proposed amendments to Rule 17a-4 would require broker-dealer SBSDs and broker-dealer MSBSPs to retain certain new records but would no longer require them to retain other records required to be kept by non-SBSD/MSBSP broker-dealers. Specifically, broker-dealer SBSDs and broker-dealer MSBSPs must preserve proposed Form SBS instead of Form

¹⁰⁰⁹ See paragraph (m)(5) of Rule 17a-4, as proposed to be amended.

¹⁰¹⁰ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended (cross-referencing paragraph (a)(11) of Rule 17a-3, as proposed to be amended (proof of money balances)).

¹⁰¹¹ See Rule 17a-4, as proposed to be amended (paragraph (b)(5) (trial balances, computations of aggregate indebtedness and net capital); paragraph (b)(8)(i) (money balance and position in securities accounts payable to customers); paragraph (b)(8)(i) (money balance and position in securities accounts payable to non-customers)).

¹⁰¹² See paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

X-17A-5,¹⁰¹³ possession or control information for security-based swap customers under proposed Rule 18a-4 instead of under Rule 15c3-3,¹⁰¹⁴ and Forms SBSE-BD and SBSE-W instead of Forms BD and BDW.¹⁰¹⁵ These proposed amendments are not expected to significantly change the number of documents that the broker-dealer must preserve, but simply the type of document that must be preserved – a factor that is not expected to affect Rule 17a-4's burden.

The Commission proposes to amend paragraph (b)(4) of Rule 17a-4 to require broker-dealer SBSBs and broker-dealer MSBSPs to retain telephone calls that have already been recorded and are related to the broker-dealer SBSB's and broker-dealer MSBSP's security-based swap business.¹⁰¹⁶ Paragraph (b)(4) of Rule 17a-4, as proposed to be amended, only requires the retention of telephonic recordings the broker-dealer SBSB or broker-dealer MSBSP voluntarily chooses to record, so the Commission's burden estimate does not include the cost of recording phone calls. Therefore, the burdens imposed by the proposed amendment would be to provide adequate physical space and computer hardware and software for storage. The Commission estimates that the proposed amendment to paragraph (b)(4) of Rule 17a-4 would impose an initial burden of 13 hours per firm. The Commission estimates that there are seventeen respondents (sixteen broker-dealer SBSBs and one broker-dealer MSBSP), resulting in an estimated industry-wide initial burden of 221 hours.¹⁰¹⁷

¹⁰¹³ See paragraph (b)(8) of Rule 17a-4, as proposed to be amended.

¹⁰¹⁴ See paragraph (b)(8)(xiv) of Rule 17a-4, as proposed to be amended.

¹⁰¹⁵ See paragraph (d) of Rule 17a-4, as proposed to be amended.

¹⁰¹⁶ See paragraph (b)(4) of Rule 17a-4, as proposed to be amended.

¹⁰¹⁷ 13 hours x 17 broker-dealer SBSBs and broker-dealer MSBSPs = 221 hours. These internal hours likely would be performed by a senior database administrator.

The Commission estimates that each firm would incur an annual burden of approximately six hours to confirm that telephonic communications are being retained in accordance with Rule 17a-4, and approximately \$2,000 for server, equipment, and systems development costs. The Commission estimates that there are seventeen respondents (sixteen broker-dealer SBSBs and one broker-dealer MSBSP), resulting in an estimated industry-wide ongoing annual cost of 102 hours¹⁰¹⁸ and \$34,000.¹⁰¹⁹

The proposed amendments to Rule 17a-4 would add three types of records to be preserved by broker-dealers.¹⁰²⁰ Because the burden to create these records is already accounted for in the PRA estimates for Rule 17a-3,¹⁰²¹ Rule 15c3-1,¹⁰²² or in proposed Regulation SBSR,¹⁰²³ the burdens imposed by these new requirements are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that the proposed amendments to paragraphs (b)(8)(v)-(viii) and proposed paragraphs (b)(8)(xvi) and (b)(14) of Rule 17a-4 would impose an initial burden of thirty-nine hours per firm and an ongoing annual burden of eighteen hours and \$360 per firm. The Commission estimates that there are forty-two respondents – sixteen broker-dealer SBSBs, one broker-dealer

¹⁰¹⁸ 6 hours x 17 broker-dealer SBSBs and broker-dealer MSBSPs = 102 hours. These internal hours likely would be performed by a compliance clerk.

¹⁰¹⁹ \$2,000 x 17 broker-dealer SBSBs and broker-dealer MSBSPs = \$34,000.

¹⁰²⁰ See Rule 17a-4, as proposed to be amended (paragraph (b)(8)(v) through (viii) (identifying information about swaps); paragraph (b)(8)(xvi) (risk margin calculation); and paragraph (b)(14) (Regulation SBSR information)).

¹⁰²¹ See *id.* See also Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3.

¹⁰²² See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3-1 (July 1, 2010), available at <http://www.reginfo.gov/public/do/DownloadDocument?documentID=184515&version=1>.

¹⁰²³ See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 FR at 75246–75250.

MSBSP, and twenty-five non-SBSD/MSBSP broker-dealers engaged in security-based swap activities.¹⁰²⁴ Thus, these proposed amendments would add to the industry an estimated initial burden of 1,638 hours¹⁰²⁵ and an ongoing annual burden of 756 hours¹⁰²⁶ and \$15,120.¹⁰²⁷

The proposed amendments to Rule 17a-4 would add five types of records to be preserved by broker-dealer SBSBs and broker-dealer MSBSPs.¹⁰²⁸ Because the burden to create these records is accounted for in the PRA estimates for Rule 17a-3,¹⁰²⁹ or proposed Rules 15Fh-1 through 15Fh-5 and 15Fk-1,¹⁰³⁰ the burdens imposed by these proposed amendments are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that the proposed amendments to paragraph (b)(1) and proposed new paragraphs (b)(15) and (b)(16) of Rule 17a-4 would impose an initial burden of sixty-five hours per firm and an ongoing annual burden of thirty hours and \$600 per firm. The Commission estimates that there are seventeen respondents (sixteen broker-dealer SBSBs and one broker-

¹⁰²⁴ 16 broker-dealer SBSBs + 1 broker-dealer MSBSP + 25 non-SBSD/MSBSP broker-dealers engaged in security-based swap activities = 42 broker-dealers engaged in security-based swap activities.

¹⁰²⁵ 39 hours x 42 respondents = 1,638 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰²⁶ 18 hours/year x 42 respondents = 756 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰²⁷ \$360 x 42 respondents = \$15,120.

¹⁰²⁸ See Rule 17a-4, as proposed to be amended (paragraph (b)(1), cross-referencing paragraph (a)(25) of Rule 17a-3, as proposed to be amended (proposed Rule 18a-3 calculations); paragraph (b)(1), cross-referencing paragraph (a)(28) of Rule 17a-3, as proposed to be amended (unverified transactions); paragraph (b)(1), cross-referencing paragraph (a)(30) of Rule 17a-3, as proposed to be amended (compliance with external business conduct standards); paragraph (b)(15) (documents and notices related to the external business conduct standards); and paragraph (b)(16) (special entity documents).

¹⁰²⁹ See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3. See also section IV.D.I. of this release.

¹⁰³⁰ See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR at 42443-42448.

dealer MSBSP), adding to the industry an initial burden of 1,105 hours¹⁰³¹ and an ongoing annual burden of 510 hours¹⁰³² and \$10,200.¹⁰³³

The proposed amendments to Rule 17a-4 would add three types of records to be preserved by broker-dealer SBSBs.¹⁰³⁴ Because the burden to create these records is accounted for in the PRA estimate for Rule 17a-3, as proposed to be amended,¹⁰³⁵ the burdens imposed by these new requirements are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that the proposed amendments to paragraph (b)(1) of Rule 17a-4 would impose an initial burden of thirty-nine hours per firm and an ongoing annual burden of eighteen hours and \$360 per firm. The Commission estimates that there are 16 broker-dealer SBSBs, adding to the industry an initial burden of 624 hours¹⁰³⁶ and an ongoing annual burden of 288 hours¹⁰³⁷ and \$5,760.¹⁰³⁸

¹⁰³¹ 65 hours x 17 broker-dealer SBSBs and broker-dealer MSBSPs = 1,105 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰³² 30 hours/year x 17 broker-dealer SBSBs and broker-dealer MSBSPs = 510 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰³³ \$600 x 17 broker-dealer SBSBs and broker-dealer MSBSPs = \$10,200.

¹⁰³⁴ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended (cross-referencing paragraph (a)(26) of Rule 17a-3, as proposed to be amended (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(27) of Rule 17a-3, as proposed to be amended (proposed Rule 18a-4 reserve account computations); and paragraph (a)(29) of Rule 17a-3, as proposed to be amended (political contributions)).

¹⁰³⁵ See section IV.D.1. of this release.

¹⁰³⁶ 39 hours x 16 broker-dealer SBSBs = 624 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰³⁷ 18 hours/year x 16 broker-dealer SBSBs = 288 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰³⁸ \$360 x 16 broker-dealer SBSBs = \$5,760.

Paragraph (b)(1) of Rule 17a-4, as proposed to be amended, would require ANC broker-dealers to preserve certain records relating to the firm's monthly liquidity stress test.¹⁰³⁹ Because the burden to create this record is accounted for in the PRA estimate for Rule 17a-3, as proposed to be amended,¹⁰⁴⁰ the burdens this new requirement would impose on ANC broker-dealers are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that the proposed amendment to paragraph (b)(1) of Rule 17a-4 would impose an initial burden of thirteen hours per firm and an ongoing annual burden of six hours and \$120 per firm. The Commission estimates that there are ten ANC broker-dealers (all of which are assumed to be dually registered as SBSDs), adding to the industry an initial burden of 130 hours¹⁰⁴¹ and an ongoing annual burden of sixty hours¹⁰⁴² and \$1,200.¹⁰⁴³

Estimated Hours and Costs of Proposed Rule 18a-6

Proposed Rule 18a-6 would require twenty-seven types of records to be preserved by stand-alone SBSDs and stand-alone MSBSPs.¹⁰⁴⁴ Proposed Rule 18a-6 does not require the firm to create these records or perform the underlying task, so the burdens imposed by these requirements would be to provide adequate physical space and computer hardware and software for storage, preserve these records for the requisite time period, and produce them when requested.¹⁰⁴⁵ The Commission estimates that the proposed record preservation requirements applicable to stand-alone SBSDs and stand-alone MSBSPs would impose an initial burden of

¹⁰³⁹ See paragraph (b)(1) of Rule 17a-4, as proposed to be amended (cross-referencing paragraph (a)(24) of Rule 17a-3, as proposed to be amended).

¹⁰⁴⁰ See section IV.D.1. of this release.

¹⁰⁴¹ 13 hours x 10 ANC broker-dealers = 130 hours. These internal hours likely would be performed by a compliance manager and a senior database administrator.

¹⁰⁴² 6 hours/year x 10 ANC broker-dealers = 60 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁴³ \$120 x 10 ANC broker-dealers = \$1,200.

364 hours,¹⁰⁴⁶ and an ongoing annual burden of 280 hours and \$5,720 per firm. The Commission estimates that there are thirteen respondents (nine stand-alone SBSDs and four stand-alone MSBSPs), resulting in an estimated industry-wide initial burden of 4,732 hours,¹⁰⁴⁷ and an industry-wide ongoing annual burden of 3,640 hours¹⁰⁴⁸ and \$74,360.¹⁰⁴⁹

Proposed Rule 18a-6 would require three types of records to be preserved by stand-alone SBSDs.¹⁰⁵⁰ Because the burden to create these records is accounted for in the PRA estimate for proposed Rule 18a-5,¹⁰⁵¹ the burdens imposed by these requirements are to ensure there is

¹⁰⁴⁴ See proposed Rule 18a-6 (paragraph (a)(1), cross-referencing paragraph (a)(1) of proposed Rule 18a-5 (trade blotters); paragraph (a)(1), cross-referencing paragraph (a)(2) of proposed Rule 18a-5 (general ledgers); paragraph (a)(1), cross-referencing paragraph (a)(3) of proposed Rule 18a-5 (ledgers of customer and non-customer accounts); paragraph (a)(1), cross-referencing paragraph (a)(4) of proposed Rule 18a-5 (stock record); paragraph (a)(1), cross-referencing paragraph (a)(5) of proposed Rule 18a-5 (memoranda of proprietary orders); paragraph (a)(1), cross-referencing paragraph (a)(6) of proposed Rule 18a-5 (confirmations); paragraph (a)(1), cross-referencing paragraph (a)(7) of proposed Rule 18a-5 (accountholder information); paragraph (a)(1), cross-referencing paragraph (a)(8) of proposed Rule 18a-5 (options positions); paragraph (a)(1), cross-referencing paragraph (a)(9) of proposed Rule 18a-5 (trial balances and computation of net capital); paragraph (a)(1), cross-referencing paragraph (a)(12) of proposed Rule 18a-5 (proposed Rule 18a-3 calculations); paragraph (a)(1), cross-referencing paragraph (a)(15) of proposed Rule 18a-5 (unverified transactions); paragraph (a)(1), cross-referencing paragraph (a)(17) of proposed Rule 18a-5 (compliance with external business conduct standards); paragraph (b)(1)(ii) (bank records); paragraph (b)(1)(iii) (bills); paragraph (b)(1)(iv) (communications); paragraph (b)(1)(v) (trial balances); paragraph (b)(1)(vi) (account documents); paragraph (b)(1)(vii) (written agreements); paragraph (b)(1)(viii) (information supporting financial reports); paragraph (b)(1)(ix) (Rule 15c3-4 risk management records); paragraph (b)(1)(xi) (Regulation SBSR information); paragraph (b)(1)(xii) (records relating to business conduct standards); paragraph (b)(1)(xiii) (special entity documents); paragraph (c) (corporate documents); paragraph (d)(1) (associated person's employment application); paragraph (d)(2)(i) (regulatory authority reports); and paragraph (d)(3)(i) (compliance, supervisory, and procedures manuals)).

¹⁰⁴⁵ See *supra* note 974.

¹⁰⁴⁶ The Commission believes that any initial dollar cost associated with proposed Rule 18a-6 is already accounted for in the PRA estimate for proposed Rule 18a-5, which includes the cost of recordkeeping system software.

¹⁰⁴⁷ 364 hours x 13 stand-alone SBSDs and stand-alone MSBSPs = 4,732 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰⁴⁸ 280 hours/year x 13 stand-alone SBSDs and stand-alone MSBSPs = 3,640 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁴⁹ \$5,720/year x 13 stand-alone SBSDs and stand-alone MSBSPs = \$74,360/year.

¹⁰⁵⁰ See paragraph (b)(1)(i) of proposed Rule 18a-6 (cross-referencing paragraph (a)(13) of proposed Rule 18a-5 (compliance with proposed Rule 18a-4 possession or control requirements); paragraph (a)(14) of proposed Rule 18a-5 (proposed Rule 18a-4 reserve account computations); and paragraph (a)(16) of proposed Rule 18a-5 (political contributions)).

¹⁰⁵¹ See section IV.D.1. of this release.

adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that the relevant portions of paragraph (b)(1)(i) of proposed Rule 18a-6 would impose an initial burden of forty-four hours per firm,¹⁰⁵² and an ongoing annual burden of thirty hours and \$360 per firm. The Commission estimates that there are nine stand-alone SBSBs, resulting in an industry-wide initial burden of 396 hours¹⁰⁵³ and an industry-wide ongoing annual burden of 270 hours¹⁰⁵⁴ and \$3,240.¹⁰⁵⁵

Proposed Rule 18a-6 would require two types of records to be preserved by ANC stand-alone SBSBs.¹⁰⁵⁶ Because the burden of actually performing the underlying task and creating the written record is already accounted for in the PRA estimates for proposed Rules 18a-1¹⁰⁵⁷ and 18a-5,¹⁰⁵⁸ the burden is the requirement to preserve these records for at least three years. The Commission estimates that paragraph (b)(1)(x) and paragraph (b)(1)(i)'s cross-reference to paragraph (a)(11) of proposed Rule 18a-5 would impose an initial burden of thirty-one hours¹⁰⁵⁹ and an ongoing annual burden of twenty hours and \$240 per ANC stand-alone SBSB. The Commission estimates that there are six ANC stand-alone SBSBs, resulting in an industry-wide

¹⁰⁵² The Commission believes that any initial dollar cost associated with proposed Rule 18a-6 is already accounted for in the PRA estimate for proposed Rule 18a-5, which includes the cost of recordkeeping system software.

¹⁰⁵³ 44 hours x 9 stand-alone SBSBs = 396 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰⁵⁴ 30 hours/year x 9 stand-alone SBSBs = 270 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁵⁵ \$360/year x 9 stand-alone SBSBs = \$3,240/year.

¹⁰⁵⁶ See proposed Rule 18a-6 (paragraph (b)(1)(i), cross-referencing paragraph (a)(11) of proposed Rule 18a-5 (liquidity stress test); and paragraph (b)(1)(x) (credit risk determinations)).

¹⁰⁵⁷ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70294.

¹⁰⁵⁸ See section IV.D.1. of this release.

¹⁰⁵⁹ The Commission believes that any initial dollar cost associated with proposed Rule 18a-6 is already accounted for in the PRA estimate for proposed Rule 18a-5, which includes the cost of recordkeeping system software.

initial burden of 186 hours¹⁰⁶⁰ and an industry-wide ongoing annual burden of 120 hours¹⁰⁶¹ and \$1,440.¹⁰⁶²

Proposed Rule 18a-6 would require eighteen types of records to be preserved by bank SBSBs and bank MSBSBs, all of which are limited to the firm's business as an SBSB or MSBSB.¹⁰⁶³ Proposed Rule 18a-6 does not require the firm to create these records or perform the underlying task, so the burdens imposed by these requirements are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. Therefore, after consideration of the similar burdens imposed by Rule 17a-4, as proposed to be amended, the Commission estimates that proposed Rule 18a-6 would impose on bank SBSBs and bank MSBSBs an initial burden of 247 hours per firm¹⁰⁶⁴ and an ongoing burden of 190 hours and \$4,520 per firm. The Commission estimates that there are twenty-five respondents (twenty-five

¹⁰⁶⁰ 31 hours x 6 ANC stand-alone SBSBs = 186 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰⁶¹ 20 hours/year x 6 ANC stand-alone SBSBs = 120 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁶² \$240/year x 6 ANC stand-alone SBSBs = \$1,440/year.

¹⁰⁶³ See proposed Rule 18a-6 (paragraph (a)(2), cross-referencing paragraph (b)(1) of proposed Rule 18a-5 (trade blotters); paragraph (a)(2), cross-referencing paragraph (b)(2) of proposed Rule 18a-5 (ledgers of security-based swap customers and non-customers); paragraph (a)(2), cross-referencing paragraph (b)(3) of proposed Rule 18a-5 (stock records); paragraph (b)(2)(i), cross-referencing paragraph (b)(4) of proposed Rule 18a-5 (memoranda of brokerage orders); paragraph (b)(2)(i), cross-referencing paragraph (b)(5) of proposed Rule 18a-5 (memoranda of proprietary orders); paragraph (b)(2)(i), cross-referencing paragraph (b)(6) of proposed Rule 18a-5 (confirmations); paragraph (b)(2)(i), cross-referencing paragraph (b)(7) of proposed Rule 18a-5 (accountholder information); paragraph (b)(2)(i), cross-referencing paragraph (b)(11) of proposed Rule 18a-5 (unverified transactions); paragraph (b)(2)(i), cross-referencing paragraph (b)(13) of proposed Rule 18a-5 (compliance with external business conduct requirements); paragraph (b)(2)(ii) (communications); paragraph (b)(2)(iii) (account documents); paragraph (b)(2)(iv) (written agreements); paragraph (b)(2)(vi) (Regulation SBSR information); paragraph (b)(2)(vii) (records relating to business conduct standards); paragraph (b)(2)(viii) (special entity documents); paragraph (d)(1) (associated person's employment application); paragraph (d)(2)(ii) (regulatory authority reports); paragraph (d)(3)(ii) (compliance, supervisory, and procedures manuals)).

¹⁰⁶⁴ The Commission believes that any initial dollar cost associated with proposed Rule 18a-6 is already accounted for in the PRA estimate for proposed Rule 18a-5, which includes the cost of recordkeeping system software.

bank SBSBs and no bank MSBSBs), resulting in an estimated industry-wide initial burden of 6,175 hours¹⁰⁶⁵ and an industry-wide ongoing annual burden of 4,750 hours¹⁰⁶⁶ and \$113,000.¹⁰⁶⁷

Proposed Rule 18a-6 would require four types of records to be preserved by bank SBSBs, all of which are limited to the firm's business as an SBSB.¹⁰⁶⁸ Because the burden to perform the underlying task or create these records is accounted for in the PRA estimates for proposed Rule 18a-4¹⁰⁶⁹ and Rule 18a-5, as proposed to be amended,¹⁰⁷⁰ the burdens imposed by these new requirements are to ensure there is adequate physical space and computer hardware and software for storage, ensure these records are preserved for the requisite time period, and produce them when requested. The Commission estimates that paragraphs (b)(9), (b)(10), and (b)(12) of proposed Rule 18a-6 would impose an initial burden of fifty-seven hours per firm¹⁰⁷¹ and an ongoing annual burden of forty hours and \$480 per firm. The Commission estimates that

¹⁰⁶⁵ 247 hours x 25 bank SBSBs = 6,175 hours. These internal hours likely would be performed by a senior database administrator.

¹⁰⁶⁶ 190 hours/year x 25 bank SBSBs = 4,750 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁶⁷ \$4,520/year x 25 bank SBSBs = \$113,000/year.

¹⁰⁶⁸ See proposed Rule 18a-6 (paragraph (b)(2)(i), cross-referencing paragraph (b)(9) (compliance with proposed Rule 18a-4 possession or control requirements) of proposed Rule 18a-5; paragraph (b)(2)(i), cross-referencing paragraph (b)(10) (proposed Rule 18a-4 reserve account computations) of proposed Rule 18a-5; paragraph (b)(2)(i), cross-referencing paragraph (b)(12) (political contributions) of proposed Rule 18a-5; and paragraph (b)(2)(v) (proposed Rule 18a-4 reserve account computations)).

¹⁰⁶⁹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

¹⁰⁷⁰ See section IV.D.1. of this release.

¹⁰⁷¹ The Commission believes that any initial dollar cost associated with proposed Rule 18a-6 is already accounted for in the PRA estimate for proposed Rule 18a-5, which includes the cost of recordkeeping system software.

there are twenty-five bank SBSBs, resulting in an industry-wide initial burden of 1,425 hours¹⁰⁷² and an industry-wide ongoing annual burden of 1,000 hours¹⁰⁷³ and \$12,000.¹⁰⁷⁴

Paragraph (f) of proposed Rule 18a-6 would require third-party custodians for non-broker-dealer SBSBs and non-broker-dealer MSBSPs to file with the Commission a written undertaking and surrender the SBSB or MSBSP's records upon the Commission's request.¹⁰⁷⁵ The obligation to provide documents upon the Commission's request does not impose a new burden, since this requirement merely changes the respondent's identity rather than adding to the quantity of burdens. Thus, the burden is the requirement to prepare and file a written undertaking. The Commission estimates that 50% of the thirty-eight non-broker-dealer SBSBs and non-broker-dealer MSBSPs would retain a third-party custodian, resulting in nineteen written undertakings. The Commission estimates paragraph (f) of proposed Rule 18a-6 would impose an ongoing annual burden of two hours per written undertaking, resulting in an industry-wide ongoing burden of thirty-eight hours per year.¹⁰⁷⁶

3. Proposed Amendments to Rule 17a-5 and Proposed Rule 18a-7

The proposed amendments to Rule 17a-5 and proposed Rule 18a-7 would impose collection of information requirements that result in annual time burdens for broker-dealers, SBSBs, and MSBSPs. The Commission estimates that the proposed amendments to Rule 17a-5 would impose the following initial and annual burdens:

¹⁰⁷² 57 hours x 25 bank SBSBs = 1,425 hours. These internal hours likely would be performed by a compliance manager and a senior database administrator.

¹⁰⁷³ 40 hours/year x 25 bank SBSBs = 1,000 hours/year. These internal hours likely would be performed by a compliance clerk.

¹⁰⁷⁴ \$480/year x 25 bank SBSBs = \$12,000/year.

¹⁰⁷⁵ See paragraph (f) of proposed Rule 18a-6.

¹⁰⁷⁶ 2 hours/year x 19 written undertakings = 38 hours/year. These internal hours likely would be performed by an attorney.

Burden	Initial Burden	Annual Burden
Liquidity stress test ¹⁰⁷⁷	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 12 hours <i>Industry:</i> 120 hours
Form SBS (ANC broker-dealer SBSDs) ¹⁰⁷⁸	<i>Per firm:</i> 25 hours <i>Industry:</i> 250 hours	<i>Per firm:</i> 228 hours <i>Industry:</i> 2,280 hours
Form SBS (non-model broker-dealer SBSDs) ¹⁰⁷⁹	<i>Per firm:</i> 50 hours <i>Industry:</i> 300 hours	<i>Per firm:</i> 240 hours <i>Industry:</i> 1,440 hours
Form SBS (broker-dealer MSBSPs) ¹⁰⁸⁰	<i>Per firm:</i> 40 hours <i>Industry:</i> 40 hours	<i>Per firm:</i> 210 hours <i>Industry:</i> 210 hours
Total – Proposed amendments to Rule 17a-5	<i>Industry:</i> 590 hours	<i>Industry:</i> 4,050 hours

The Commission estimates that proposed Rule 18a-7 would impose the following initial and annual burdens:

Burden	Initial Burden	Annual Burden
Additional ANC reports ¹⁰⁸¹	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 132 hours <i>Industry:</i> 792 hours
Customer statements ¹⁰⁸²	<i>Per firm:</i> 10 hours <i>Industry:</i> 130 hours	<i>Per firm:</i> 1 hours <i>Industry:</i> 13 hours
Annual report (stand-alone SBSDs) ¹⁰⁸³	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 70 hours and \$5.60 <i>Industry:</i> 630 hours and \$50.40
Annual report (stand-alone MSBSPs) ¹⁰⁸⁴	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 10 hours and \$5.60 <i>Industry:</i> 40 hours and \$22.40
Statement regarding accountant ¹⁰⁸⁵	<i>Per firm:</i> 10 hours <i>Industry:</i> 130 hours	<i>Per firm:</i> 2 hours and 46¢ <i>Industry:</i> 26 hours and \$5.98
Engagement of accountant (stand-alone SBSDs) ¹⁰⁸⁶	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> \$450,000 <i>Industry:</i> \$4,050,000
Engagement of accountant (stand-alone MSBSPs) ¹⁰⁸⁷	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> \$300,000 <i>Industry:</i> \$1,200,000
Notice of change of fiscal year ¹⁰⁸⁸	<i>Per firm:</i> 0 hours <i>Industry:</i> 0 hours	<i>Per firm:</i> 1 hour and 46¢ <i>Industry:</i> 1 hour and 46¢

¹⁰⁷⁷ See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

¹⁰⁷⁸ See paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended.

¹⁰⁷⁹ See paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended.

¹⁰⁸⁰ See paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended.

¹⁰⁸¹ See paragraph (a)(3) of proposed Rule 18a-7.

¹⁰⁸² See paragraph (b) of proposed Rule 18a-7.

¹⁰⁸³ See paragraphs (c) and (d) of proposed Rule 18a-7.

¹⁰⁸⁴ See paragraphs (c) and (d) of proposed Rule 18a-7.

¹⁰⁸⁵ See paragraph (e) of proposed Rule 18a-7.

¹⁰⁸⁶ See paragraph (f) of proposed Rule 18a-7.

¹⁰⁸⁷ See paragraph (f) of proposed Rule 18a-7.

¹⁰⁸⁸ See paragraph (j) of proposed Rule 18a-7.

Form SBS (stand-alone SBSDs) ¹⁰⁸⁹	<i>Per firm:</i> 160 hours <i>Industry:</i> 1,440 hours	<i>Per firm:</i> 192 hours <i>Industry:</i> 1,728 hours
Form SBS (stand-alone MSBSPs) ¹⁰⁹⁰	<i>Per firm:</i> 40 hours <i>Industry:</i> 160 hours	<i>Per firm:</i> 48 hours <i>Industry:</i> 192 hours
Form SBS (bank SBSDs) ¹⁰⁹¹	<i>Per firm:</i> 36 hours <i>Industry:</i> 900 hours	<i>Per firm:</i> 16 hours <i>Industry:</i> 400 hours
Total – Proposed Rule 18a-7	<i>Industry:</i> 2,890 hours	<i>Industry:</i> 3,978 hours and \$5,250,079.24

Estimated Hours and Costs of Proposed Amendments to Rule 17a-5

No Change in Estimated Burden. Many of the proposed amendments to Rule 17a-5 are not expected to change the estimated burden imposed by Rule 17a-5. Most of the additional proposed amendments discussed in section II.B.3.b. of this release are clarifying changes that should not affect the Commission's burden estimate.

The Commission is proposing that the financial report prepared by Form SBS filers include statements and supporting schedules from proposed Form SBS instead of from Form X-17A-5.¹⁰⁹² This is not so much a new burden as a different burden, since in the absence of this proposed amendment, these firms would be required to file statements and supporting schedules from Form X-17A-5 instead. In addition, the burden of preparing these statements and supporting schedules is already accounted for in the PRA burden for proposed Form SBS (discussed below).

The Commission does not estimate an additional burden associated with its proposal that the compliance report include statements as to a broker-dealer SBSD's compliance with proposed Rule 18a-4,¹⁰⁹³ because the burden to comply with proposed Rule 18a-4 is largely

¹⁰⁸⁹ See paragraph (a)(1) of proposed Rule 18a-7.

¹⁰⁹⁰ See paragraph (a)(1) of proposed Rule 18a-7.

¹⁰⁹¹ See paragraph (a)(2) of proposed Rule 18a-7.

¹⁰⁹² See paragraph (d)(2) of Rule 17a-5, as proposed to be amended.

¹⁰⁹³ See paragraph (d)(3) of Rule 17a-5, as proposed to be amended.

already accounted for in the PRA estimate for proposed Rule 18a-4.¹⁰⁹⁴ To the extent that the burden is not already accounted for in the PRA estimate for proposed Rule 18a-4, the Commission believes that broker-dealer SBSDs and broker-dealer MSBSPs would already have a system in place for confirming compliance with proposed Rule 18a-4, in accordance with best practices. In addition, the Commission believes that the sixteen broker-dealers expected to register as SBSDs should already have procedures in place for confirming compliance since they are already required to confirm compliance with analogous Rule 15c3-3 (which Rule 18a-4 is modeled on).

The Commission is proposing to amend Rule 17a-5 to require that broker-dealers attach Part III of Form X-17A-5 to the annual report.¹⁰⁹⁵ However, the Commission does not expect this amendment to increase Rule 17a-5's burden, since broker-dealers currently file Part III with their audited annual report pursuant to staff guidance and Rule 617.¹⁰⁹⁶

Liquidity Stress Test. The Commission proposes to add paragraph (a)(5)(vii) to Rule 17a-5, which would require ANC broker-dealers to file the results of the firm's monthly liquidity stress test with the Commission.¹⁰⁹⁷ Because the burden of actually performing the liquidity stress test and creating a liquidity funding plan is already accounted for in the PRA estimate for

¹⁰⁹⁴ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

¹⁰⁹⁵ See paragraph (e)(2) of Rule 17a-5, as proposed to be amended.

¹⁰⁹⁶ See 17 CFR 249.617; Commission, Division of Trading and Markets, Broker-Dealer Notices and Reports, available at <http://www.sec.gov/divisions/marketreg/bdnotices.htm>. In addition, Part III of Form X-17A-5, as proposed to be amended, would add a reference to Rule 17a-12, which applies to OTC derivatives dealers. Rule 17a-12 does not explicitly require OTC derivatives dealers to complete Part III of Form X-17A-5, but this proposed amendment to Part III of Form X-17A-5 is not expected to result in a burden increase since all [four] OTC derivatives dealers already voluntarily file Part III with their audited annual reports.

¹⁰⁹⁷ See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

the proposed amendments to Rule 15c3-1,¹⁰⁹⁸ the burden imposed by proposed paragraph (a)(5)(vii) is the requirement to file a copy of the results with the Commission. The Commission estimates that paragraph (a)(5)(vii) to Rule 17a-5, as proposed to be amended, would impose an annual burden of twelve hours per ANC broker-dealer.¹⁰⁹⁹ The Commission estimates that there are ten ANC broker-dealers (all of which are assumed to be dually registered as SBSDs), resulting in an industry-wide ongoing burden of 120 hours per year.¹¹⁰⁰

Proposed Form SBS. Paragraph (a)(1)(iv) of Rule 17a-5, as proposed to be amended, would require broker-dealer SBSDs and broker-dealer MSBSPs to file proposed Form SBS monthly instead of filing the applicable part of Form X-17A-5 quarterly.¹¹⁰¹ Part II, Part IIA, and Part II CSE of Form X-17A-5 each impose a different burden on respondents due to their varying lengths and calculations, so the burden of filing proposed Form SBS depends on which part of Form X-17A-5 the firm is currently required to file.

ANC broker-dealer SBSDs would be required to file proposed Form SBS instead of Part II CSE of Form X-17A-5. Although proposed Form SBS is modeled on Part II CSE, the burden on ANC broker-dealer SBSDs would increase, because ANC broker-dealer SBSDs would file monthly instead of quarterly and would complete additional sections and line items eliciting more detail about their security-based swap and swap activities.¹¹⁰² In consideration of these

¹⁰⁹⁸ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70294.

¹⁰⁹⁹ 1 hour/filing x 12 months/year = 12 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁰⁰ 12 hours/year x 10 ANC broker-dealers = 120 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁰¹ Compare 17 CFR 240.17a-5(a)(3)(ii) and (iii), with paragraph (a)(4)(iv) of Rule 17a-5, as proposed to be amended.

¹¹⁰² ANC broker-dealer SBSDs would be required to complete the following new sections: (1) Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A; (2) Information for Possession or Control Requirements under Rule 18a-4; (3) Schedule 1 – Aggregate Securities, Commodities, and Swaps

additional requirements, the Commission estimates that the requirement for ANC broker-dealer SBSDs to file proposed Form SBS every month would add an initial burden of twenty-five hours per firm and an ongoing annual burden of 228 hours per firm. The Commission estimates that there are ten ANC broker-dealer SBSDs, adding to the industry an initial burden of 250 hours¹¹⁰³ and an ongoing burden of 2,280 hours per year.¹¹⁰⁴

Non-model broker-dealer SBSDs would be required to file proposed Form SBS instead of Part II or Part IIA of Form X-17A-5. Given that SBSDs are expected to be larger and relatively sophisticated firms, the Commission assumes that all non-model broker-dealer SBSDs are carrying firms that file Part II. Although sections of Part II are also found in proposed Form SBS, the burden on non-model broker-dealer SBSDs would increase (but not as much as for ANC broker-dealer SBSDs), because non-model broker-dealer SBSDs would file monthly instead of quarterly and would complete additional sections and line items eliciting more detail about their security-based swap and swap activities.¹¹⁰⁵ In consideration of these additional

Positions; and (4) Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries.

¹¹⁰³ 25 hours x 10 ANC broker-dealer SBSDs = 250 hours. These internal hours likely would be performed by a compliance manager.

¹¹⁰⁴ 228 hours/year x 10 ANC broker-dealer SBSDs = 2,280 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁰⁵ Non-model broker-dealer SBSDs would be required to complete the following new sections: (1) Financial and Operational Data – Operational Deductions from Capital – Note A; (2) Financial and Operational Data – Potential Operational Charges Not Deducted from Capital – Note B; (3) Computation for Determination of PAB Requirements; (4) Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A; (5) Information for Possession or Control Requirements under Rule 18a-4; (6) Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions; (7) Schedule 2 – Credit Concentration Report for Fifteen Largest Current Exposures in Derivatives; (8) Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating; and (9) Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries. In addition, non-model broker-dealer SBSDs also registered as FCMs would be required to file the following sections not included on Part II, but which the CFTC already requires or has proposed to require FCMs to file as part of Form 1-FR-FCM: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options

requirements, the Commission estimates that the requirement for non-model broker-dealer SBSDs to file proposed Form SBS every month would add an initial burden of fifty hours per firm and an ongoing annual burden of 240 hours per firm. The Commission estimates that there are six non-model broker-dealer SBSDs, adding to the industry an initial burden of 300 hours¹¹⁰⁶ and an ongoing burden of 1,440 hours per year.¹¹⁰⁷

Broker-dealer MSBSPs would be required to file proposed Form SBS instead of Part II or Part IIA of Form X-17A-5. Given that MSBSPs are expected to be larger and relatively sophisticated firms, the Commission assumes that broker-dealer MSBSPs are carrying firms that file Part II. Although sections of Part II are also found in proposed Form SBS, the burden on broker-dealer MSBSPs would increase (but not as much as for broker-dealer SBSDs), because broker-dealer MSBSPs would file monthly instead of quarterly and would complete additional sections and line items eliciting more detail about their security-based swap and swap activities.¹¹⁰⁸ In consideration of these additional requirements, the Commission estimates that

Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections from Form 1-FR-FCM, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁰⁶ 50 hours x 6 non-model broker-dealer SBSDs = 300 hours. These internal hours likely would be performed by a compliance manager.

¹¹⁰⁷ 240 hours/year x 6 non-model broker-dealer SBSDs = 1,440 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁰⁸ Broker-dealer MSBSPs would be required to complete the following new sections: (1) Computation of Tangible Net Worth (which is only 3 lines long); (2) Financial and Operational Data – Operational Deductions from Capital – Note A; (3) Financial and Operational Data – Potential Operational Charges Not Deducted from Capital – Note B; (4) Computation for Determination of PAB Requirements; (5) Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions; (6) Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives; (7) Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating; and (8) Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries. In addition, broker-dealer MSBSPs also registered as FCMs would be required to file the following sections not included on Part II, but which the CFTC already requires or has proposed to require FCMs to file as part of Form 1-FR-FCM: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers

the requirement for broker-dealer MSBSPs to file proposed Form SBS every month would add an initial burden of forty hours per firm and an ongoing annual burden of 210 hours per firm. The Commission estimates that there would be one broker-dealer MSBSP, such that the estimated burden on the industry would be the same as for a single broker-dealer MSBSP.

Estimated Hours and Costs of Proposed Rule 18a-7

Proposed Rule 18a-7, which is modeled on Rule 17a-5, as proposed to be amended, would require non-broker-dealer SBSs and non-broker-dealer MSBSPs to satisfy certain reporting requirements.¹¹⁰⁹

Additional ANC reports. Paragraph (a)(3) of proposed Rule 18a-7 would require ANC stand-alone SBSs to periodically file certain additional reports relating to their use of internal models to calculate net capital.¹¹¹⁰ After consideration of the Supporting Statement accompanying the most recent extension of Rule 17a-5, which estimates that the requirement to file additional ANC reports imposes a burden of 120 hours per respondent,¹¹¹¹ as well as the proposal to amend Rule 17a-5 to require ANC broker-dealers to file the results of their monthly liquidity stress tests with the additional ANC reports,¹¹¹² the Commission estimates that

Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections from Form 1-FR-FCM, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁰⁹ See proposed Rule 18a-7.

¹¹¹⁰ See paragraph (a)(3) of proposed Rule 18a-7.

¹¹¹¹ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-5 (4 hours/monthly report x 12 months/year + 8 hours/quarterly report x 4 quarters/year + 40 hours/annual report = 120 hours/year).

¹¹¹² See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

paragraph (a)(3) of proposed Rule 18a-7 would impose an annual burden of 132 hours per ANC stand-alone SBSD.¹¹¹³ The Commission estimates that there are six ANC stand-alone SBSDs, resulting in an industry-wide ongoing burden of 792 hours per year.¹¹¹⁴

Customer Statements. Paragraph (b) of proposed Rule 18a-7 would require stand-alone SBSDs and stand-alone MSBSPs to disclose certain financial statements on their Internet websites.¹¹¹⁵ After consideration of the Supporting Statement accompanying the most recent extension of Rule 17a-5, which requires similar disclosures by mail instead of on the firm's website,¹¹¹⁶ the Commission staff's experience with burden estimates for similar collections of information, and the estimated initial web development costs, the Commission estimates that paragraph (b) of proposed Rule 18a-7 would impose an initial burden of ten hours per firm and an annual burden of one hour per firm. The Commission estimates that there are thirteen respondents (nine stand-alone SBSDs and four stand-alone MSBSPs), resulting in an industry-wide initial burden of 130 hours¹¹¹⁷ and an industry-wide ongoing burden of thirteen hours per year.¹¹¹⁸

¹¹¹³ 120 hours/year + 1 hour/liquidity stress test filing x 12 months/year = 132 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹¹⁴ 132 hours/year x 6 ANC stand-alone SBSDs = 792 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹¹⁵ See paragraph (b) of proposed Rule 18a-7. The Commission does not anticipate a dollar cost to establish a website and a toll-free number under this paragraph, because the Commission believes firms that are large enough to register as an SBSD or MSBSP already maintain a toll-free number for their customers and already have an Internet website. See Broker-Dealer Exemption from Sending Certain Financial Information to Customers, Exchange Act Release No. 48272 (Aug. 1, 2003), 68 FR 46446, 46450 (Aug. 6, 2003).

¹¹¹⁶ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-5. See section II.B.3.a. of this release for a discussion of the similarities between paragraph (c) of Rule 17a-5 and paragraph (b) of proposed Rule 18a-7.

¹¹¹⁷ 10 hours x 13 stand-alone SBSDs and stand-alone MSBSPs = 130 hours. These internal hours likely would be performed by a compliance manager.

¹¹¹⁸ 1 hour/year x 13 stand-alone SBSDs and stand-alone MSBSPs = 13 hours/year. These internal hours likely would be performed by a compliance clerk.

Annual Reports. Paragraph (c) of proposed Rule 18a-7 would require stand-alone SBSs and stand-alone MSBSPs to file with the Commission an annual report consisting of certain financial reports.¹¹¹⁹ In addition, paragraph (d) of proposed Rule 18a-7 requires the filing firm to attach Part III of Form X-17A-5 to the annual report.¹¹²⁰ Part III must include an oath or affirmation, which implicitly requires a senior officer or a trusted delegate to review the annual report. Based on the Commission staff's experience with the burden imposed by current Rule 17a-5's annual report requirement and related postage costs,¹¹²¹ the Commission estimates that paragraphs (c) and (d) of proposed Rule 18a-7 would impose on stand-alone MSBSPs an annual burden of ten hours and \$5.60 per firm. The Commission estimates that there are four stand-alone MSBSPs, resulting in an industry-wide ongoing burden of forty hours¹¹²² and \$22.40 per year.¹¹²³

Unlike stand-alone MSBSPs, stand-alone SBSs would be required to include a compliance report with their annual reports.¹¹²⁴ Thus, after consideration of the Commission's recent release adopting amendments to Rule 17a-5, which estimates that each compliance report takes approximately sixty hours to prepare,¹¹²⁵ the Commission estimates that paragraphs (c) and (d) of proposed Rule 18a-7 would impose an annual burden of seventy hours and \$5.60 per

¹¹¹⁹ See paragraph (c) of proposed Rule 18a-7.

¹¹²⁰ See paragraph (d) of proposed Rule 18a-7.

¹¹²¹ As of May 2013, a priority mail flat rate envelope costs \$5.60, based on costs obtained on the U.S. Postal Service website at www.usps.gov.

¹¹²² 10 hours/year x 4 stand-alone MSBSPs = 40 hours/year. These internal hours likely would be performed by a senior accountant.

¹¹²³ \$5.60/year x 4 stand-alone MSBSPs = \$22.40/year.

¹¹²⁴ See paragraph (c)(1)(i)(B) of proposed Rule 18a-7.

¹¹²⁵ See Broker-Dealer Reports, 78 FR at 51960.

stand-alone SBSD. The Commission estimates that there are nine stand-alone SBSDs, resulting in an industry-wide ongoing burden of 630 hours¹¹²⁶ and \$50.40 per year.¹¹²⁷

Statement regarding Independent Public Accountant. Paragraph (e) of proposed Rule 18a-7 would require stand-alone SBSDs and stand-alone MSBSPs to file a statement regarding the independent public accountant engaged to audit the firm's annual reports.¹¹²⁸ In addition to postage costs, the Commission's recent release estimates that the parallel requirement in Rule 17a-5 would impose a two-hour burden on each introducing broker-dealer to file an updated statement, and a more significant ten-hour burden on each carrying broker-dealer, since the changes would require renegotiating the carrying broker-dealer's agreement with its independent public accountant.¹¹²⁹ Consistent with that release, the Commission estimates that paragraph (e) of proposed Rule 18a-7 would impose an initial burden of ten hours per firm and an annual burden of two hours and 46 cents per firm.¹¹³⁰ The Commission estimates that there are thirteen respondents (nine stand-alone SBSDs and four stand-alone MSBSPs), resulting in an industry-wide initial burden of 130 hours¹¹³¹ and an industry-wide ongoing burden of twenty-six hours¹¹³² and \$5.98 per year.¹¹³³

¹¹²⁶ 70 hours/year x 9 stand-alone SBSDs = 630 hours/year. These internal hours likely would be performed by a senior accountant.

¹¹²⁷ \$5.60/year x 9 stand-alone SBSDs = \$50.40/year.

¹¹²⁸ See paragraph (e) of proposed Rule 18a-7.

¹¹²⁹ See Broker-Dealer Reports, 78 FR at 51962.

¹¹³⁰ It currently costs 46 cents to send a one ounce retail domestic first-class letter through the U.S. Postal Service. See U.S. Postal Service, First-Class Mail, <https://www.usps.com/ship/first-class.htm> (last visited Oct. 25, 2013).

¹¹³¹ 10 hours x 13 stand-alone SBSDs and stand-alone MSBSPs = 130 hours. These internal hours likely would be performed by a senior accountant.

¹¹³² 2 hours/year x 13 stand-alone SBSDs and stand-alone MSBSPs = 26 hours/year. These internal hours likely would be performed by a compliance clerk.

¹¹³³ 46¢/year x 13 stand-alone SBSDs and stand-alone MSBSPs = \$5.98/year.

Engagement of the Independent Public Accountant. Paragraph (f) of proposed Rule 18a-7 would require stand-alone SBSDs and stand-alone MSBSPs to engage an independent public accountant to provide reports covering the firm's annual reports.¹¹³⁴ The Commission's recent release adopting amendments to Rule 17a-5 estimates that it would cost each carrying firm \$300,000 to retain an independent public accountant to audit its financial statements and \$150,000 to examine its compliance report.¹¹³⁵ Given that SBSDs and MSBSPs are expected to be larger and relatively sophisticated firms, the Commission assumes that they are carrying firms that would incur the \$300,000 cost to audit their financial statements. However, since only stand-alone SBSDs are required to file a compliance report,¹¹³⁶ only they (and not stand-alone MSBSPs) would be required to retain an independent public accountant to review their compliance reports.

Therefore, the Commission estimates that paragraph (f) of proposed Rule 18a-7 would impose an annual cost of \$300,000 on each stand-alone MSBSP. The Commission estimates that there are four stand-alone MSBSPs, resulting in an industry-wide ongoing burden of \$1,200,000 per year.¹¹³⁷ The Commission estimates that paragraph (f) of proposed Rule 18a-7 would impose on stand-alone SBSDs an annual cost of \$450,000 per firm,¹¹³⁸ since both their financial statements and compliance report would need to be audited. The Commission estimates that there are nine stand-alone SBSDs, resulting in an industry-wide ongoing burden of \$4,050,000 per year.¹¹³⁹

¹¹³⁴ See paragraph (f) of proposed Rule 18a-7.

¹¹³⁵ See Broker-Dealer Reports, 78 FR at 51963.

¹¹³⁶ See paragraph (c)(1)(i)(B) of proposed Rule 18a-7.

¹¹³⁷ \$300,000/year x 4 stand-alone MSBSPs = \$1,200,000/year.

¹¹³⁸ \$300,000/year (financial statements) + \$150,000/year (compliance report) = \$450,000/year.

¹¹³⁹ \$450,000/year x 9 stand-alone SBSDs = \$4,050,000/year.

Notice of Change in Fiscal Year. Paragraph (j) of proposed Rule 18a-7 would require stand-alone SBSs and stand-alone MSBSs to notify the Commission of a change in fiscal year.¹¹⁴⁰ Based on the Commission staff's experience with the parallel requirement under Rule 17a-5, and the Supporting Statement accompanying the most recent extension of Rule 17a-11, which estimates that each financial notice takes approximately one hour to prepare and file with the Commission,¹¹⁴¹ the Commission estimates that paragraph (j) of proposed Rule 18a-7 would impose a burden of one hour and 46 cents on a firm planning to change its fiscal year. The Commission estimates that each year, one firm will change its fiscal year, such that the estimated burden on the industry would be one hour and 46 cents per year.

Proposed Form SBS. Proposed Rule 18a-7 would require stand-alone SBSs and stand-alone MSBSs to file proposed Form SBS monthly,¹¹⁴² and would require bank SBSs and bank MSBSs to file proposed Form SBS quarterly.¹¹⁴³ Stand-alone SBSs and stand-alone MSBSs would be required to complete more sections of proposed Form SBS than bank SBSs and bank MSBSs, and would therefore experience a greater burden.

Stand-alone SBSs would be required to file proposed Form SBS on a monthly basis.¹¹⁴⁴ Proposed Form SBS includes eleven sections and five schedules applicable to stand-alone SBSs.¹¹⁴⁵ Stand-alone SBSs dually registered as FCMs would be required to complete five

¹¹⁴⁰ See paragraph (j) of proposed Rule 18a-7.

¹¹⁴¹ See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11 (June 29, 2012), available at <http://www.reginfo.gov/public/do/DownloadDocument?documentID=332313&version=1>.

¹¹⁴² See paragraph (a)(1) of proposed Rule 18a-7.

¹¹⁴³ See paragraph (a)(2) of proposed Rule 18a-7.

¹¹⁴⁴ See paragraph (a)(1) of proposed Rule 18a-7.

¹¹⁴⁵ Stand-alone SBSs would be required to complete the following sections and schedules: (1) Statement of Financial Condition; (2) either Computation of Net Capital (Filer Authorized to Use Models) or Computation of Net Capital (Filer Not Authorized to Use Models); (3) Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer); (4) Statement of Income (Loss); (5) Capital

additional sections, all of which the CFTC already requires or has proposed to require FCMs to file as part of Form 1-FR-FCM.¹¹⁴⁶ In consideration of these additional requirements, the Commission estimates that the requirement for stand-alone SBSs to file proposed Form SBS every month would impose an initial burden of 160 hours per firm and an ongoing annual burden of 192 hours per firm. The Commission estimates that there are nine stand-alone SBSs, resulting in an industry-wide initial burden of 1,440 hours¹¹⁴⁷ and an industry-wide ongoing burden of 1,728 hours per year.¹¹⁴⁸

Stand-alone MSBSPs would be required to file proposed Form SBS on a monthly basis.¹¹⁴⁹ Proposed Form SBS includes three sections and five schedules applicable to stand-alone MSBSPs.¹¹⁵⁰ Stand-alone MSBSPs dually registered as FCMs would be required to

Withdrawals; (6) Capital Withdrawals – Recap; (7) Financial and Operational Data; (8) Financial and Operational Data – Operational Deductions from Capital – Note A; (9) Financial and Operational Data – Potential Operational Charges Not Deducted from Capital – Note B; (10) Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A; (11) Information for Possession or Control Requirements under Rule 18a-4; (12) Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions; (13) Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives; (14) Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating; and (15) Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries.

¹¹⁴⁶ Stand-alone SBSs also registered as FCMs would be required to file the following sections: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁴⁷ 160 hours x 9 stand-alone SBSs = 1,440 hours. These internal hours likely would be performed by a senior compliance manager.

¹¹⁴⁸ 192 hours/year x 9 stand-alone SBSs = 1,728 hours/year. These internal hours likely would be performed by a senior compliance manager.

¹¹⁴⁹ See paragraph (a)(1) of proposed Rule 18a-7.

¹¹⁵⁰ Stand-alone MSBSPs would be required to complete the following sections and schedules: (1) Statement of Financial Condition; (2) Computation of Tangible Net Worth; (3) Statement of Income (Loss);

complete five additional sections, all of which the CFTC already requires or has proposed to require FCMs to file as part of Form 1-FR-FCM.¹¹⁵¹ In consideration of these additional requirements, the Commission estimates that the requirement for stand-alone MSBSPs to file proposed Form SBS every month would impose an initial burden of forty hours per firm and an ongoing annual burden of sixty hours per firm. The Commission estimates that there are four stand-alone MSBSPs, resulting in an industry-wide initial burden of 160 hours¹¹⁵² and an industry-wide ongoing burden of 192 hours per year.¹¹⁵³

Bank SBSDs would be required to file proposed Form SBS on a quarterly basis.¹¹⁵⁴

Proposed Form SBS includes five sections and one schedule applicable to bank SBSDs.¹¹⁵⁵ The Commission does not expect proposed Form SBS to impose a significant burden on bank

(4) Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions; (5) Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives; (6) Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating; and (7) Schedule 4 –Geographic Distribution of Derivatives Exposures for Ten Largest Countries.

¹¹⁵¹ Stand-alone MSBSPs also registered as FCMs would be required to file the following sections: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁵² 40 hours x 4 stand-alone MSBSPs = 160 hours. These internal hours likely would be performed by a senior compliance manager.

¹¹⁵³ 48 hours/year x 4 stand-alone MSBSPs = 192 hours/year. These internal hours likely would be performed by a senior compliance manager.

¹¹⁵⁴ See paragraph (a)(2) of proposed Rule 18a-7.

¹¹⁵⁵ Bank SBSDs would be required to complete the following sections and schedules: (1) Balance Sheet (Information as Reported on FFIEC Form 031 – Schedule RC); (2) Regulatory Capital (Information as Reported on FFIEC Form 031 – Schedule RC-R); (3) Income Statement (Information as Reported on FFIEC Form 031 – Schedule RI); (4) Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A; (5) Information for Possession or Control Requirements under Rule 18a-4; and (6) Schedule 1 – Derivative Positions.

SBSDs, because two of the five sections require the firm to file calculations already computed in accordance with proposed Rule 18a-3, and the other three sections either mirror or are scaled down versions of schedules to FFIEC Form 031, which banks are already required to file with their prudential regulator (although they would need to transpose this information from FFIEC Form 031 to Form SBS). Although bank SBSBs dually registered as FCMs would be required to complete 5 additional sections, the CFTC already requires or has proposed to require FCMs to file these schedules on Form 1-FR-FCM.¹¹⁵⁶ In consideration of these additional requirements, the Commission estimates that the requirement for bank SBSBs to file proposed Form SBS quarterly would impose an initial burden of 36 hours per firm and an ongoing annual burden of sixteen hours per firm. The Commission estimates that there are twenty-five bank SBSBs, resulting in an industry-wide initial burden of 900 hours¹¹⁵⁷ and an industry-wide ongoing burden of 400 hours per year.¹¹⁵⁸

Bank MSBSPs would be required to file proposed Form SBS on a quarterly basis.¹¹⁵⁹

Proposed Form SBS includes three sections and one schedule applicable to bank MSBSPs.¹¹⁶⁰

¹¹⁵⁶ Bank SBSBs also registered as FCMs would be required to file the following sections: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁵⁷ 36 hours x 25 bank SBSBs = 900 hours. These internal hours likely would be performed by a senior compliance manager.

¹¹⁵⁸ 16 hours/year x 25 bank SBSBs = 400 hours/year. These internal hours likely would be performed by a senior compliance manager.

¹¹⁵⁹ See paragraph (a)(2) of proposed Rule 18a-7.

¹¹⁶⁰ Bank MSBSPs would be required to complete the following sections and schedules: (1) Balance Sheet (Information as Reported on FFIEC Form 031 – Schedule RC); (2) Regulatory Capital (Information as

Bank MSBSPs dually registered as FCMs would be required to complete five additional sections, all of which the CFTC already requires or has proposed to require FCMs to file as part of Form 1-FR-FCM.¹¹⁶¹ However, the Commission does not expect any banks to register with the Commission as MSBSPs and therefore does not anticipate these requirements to impose an additional burden.¹¹⁶²

4. Proposed Amendments to Rule 17a-11 and Proposed Rule 18a-8

The proposed amendments to Rule 17a-11 and proposed Rule 18a-8 would impose collection of information requirements that result in annual time burdens for broker-dealers, SBSs, and MSBSPs. Current Rule 17a-11 imposes an estimated annual burden of 1 hour per firm and a total industry burden of 443 hours.¹¹⁶³ The Commission estimates that the proposed amendments to Rule 17a-11 would impose the following initial and annual burdens:

Reported on FFIEC Form 031 – Schedule RC-R); (3) Income Statement (Information as Reported on FFIEC Form 031 – Schedule RI); and (4) Schedule 1 –Derivative Positions.

¹¹⁶¹ Bank MSBSPs also registered as FCMs would be required to file the following sections: (1) Computation of CFTC Minimum Capital Requirement; (2) Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges; (3) Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act; (4) Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and (5) Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7. The Commission does not estimate a burden for these 5 sections, since the CFTC already requires FCMs to file these 5 sections on a monthly basis (17 CFR 1.10(b)(i)), and therefore, the hourly burden is already accounted for in the PRA estimate for the CFTC's Rule 1.10 (1 CFR 1.10). In addition, the Commission does not anticipate that FCMs will be required to file both the CFTC's Form 1-FR-FCM and the Commission's proposed Form SBS.

¹¹⁶² The Commission estimates that the requirement for bank MSBSPs to file proposed Form SBS quarterly would impose an initial burden of 16 hours per firm and an ongoing annual burden of 8 hours per firm.

¹¹⁶³ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

Burden	Annual Burden
New notice of insufficient liquidity reserve ¹¹⁶⁴	<i>Per notice:</i> 1 hour <i>Industry:</i> 1 hour
New notice of failure to deposit in Rule 18a-4 account ¹¹⁶⁵	<i>Per notice:</i> 1 hour <i>Industry:</i> 100 hours
New notices filed by exchanges and national securities associations ¹¹⁶⁶	<i>Per notice:</i> 1 hour <i>Industry:</i> 10 hours
Total – Proposed amendments to Rule 17a-11	<i>Industry:</i> 111 hours

The Commission estimates that proposed Rule 18a-8 would impose an annual burden of 4.6 hours per year.

Estimated Ongoing Hours and Costs of Current Rule 17a-11

In the Supporting Statement accompanying the most recent extension of Rule 17a-11's collection, the Commission estimates that it takes one hour to prepare and file a notice required under Rule 17a-11.¹¹⁶⁷ Given that 443 Rule 17a-11 notices were filed in 2012, current Rule 17a-11 creates an estimated industry-wide ongoing burden of 443 hours per year.¹¹⁶⁸

Estimated Hours and Costs of Proposed Amendments to Rule 17a-11

The Commission proposes to add paragraph (b)(6) to Rule 17a-11, which would require broker-dealer MSBSPs to notify the Commission if their tangible net worth falls below \$20 million.¹¹⁶⁹ Because the burden of actually calculating the firm's tangible net worth is already accounted for in the PRA estimate for proposed Rule 18a-2,¹¹⁷⁰ the burden imposed by paragraph (b)(6) of Rule 17a-11, as proposed to be amended, is the requirement to notify the Commission

¹¹⁶⁴ See paragraph (e) of Rule 17a-11, as proposed to be amended.

¹¹⁶⁵ See paragraph (f) of Rule 17a-11, as proposed to be amended.

¹¹⁶⁶ See paragraph (g) of Rule 17a-11, as proposed to be amended.

¹¹⁶⁷ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

¹¹⁶⁸ 1 hour/notice x 443 notices/year = 443 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁶⁹ See paragraph (b)(6) of Rule 17a-11, as proposed to be amended.

¹¹⁷⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70290.

when the firm's tangible net worth falls to a certain level. However, the Commission does not expect to receive any notices under this provision, since the Commission expects only one broker-dealer MSBSP, which would already be subject to the more stringent net capital requirements applicable to broker-dealers. Thus, the Commission does not expect paragraph (b)(6) of Rule 17a-11, as proposed to be amended, to impose an additional burden.

The Commission proposes to add paragraph (e) to Rule 17a-11, which would require ANC broker-dealers to notify the Commission if the monthly liquidity stress test indicates that the firm's liquidity reserve is insufficient.¹¹⁷¹ Because the burden of actually performing the liquidity stress test is already accounted for in the PRA estimate for Rule 15c3-1,¹¹⁷² the burden imposed by paragraph (e) of Rule 17a-11, as proposed to be amended, is the requirement to notify the Commission of certain adverse test results. Given the similarity in the rules, the Commission estimates that each required notice would take one hour to prepare and file.¹¹⁷³ The Commission does not expect to receive many notices under paragraph (e) of Rule 17a-11, given that it did not receive any Rule 17a-11 notices from ANC broker-dealers in 2012. However, since the Commission estimates that 4 additional firms will register as ANC broker-dealers, the Commission estimates that one notice per year would be filed under paragraph (e) of Rule 17a-11, resulting in an industry-wide ongoing burden of one hour per year.¹¹⁷⁴

The Commission proposes to add paragraph (f) to Rule 17a-11, which requires broker-dealer SBSBs to notify the Commission if they fail to make a deposit required under

¹¹⁷¹ See paragraph (e) of Rule 17a-11, as proposed to be amended.

¹¹⁷² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70294.

¹¹⁷³ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

¹¹⁷⁴ 1 notice/year x 1 hour/notice = 1 hour/year. This internal hour likely would be performed by a compliance manager.

proposed Rule 18a-4.¹¹⁷⁵ Because the burden to calculate the reserve amount is already accounted for in the PRA estimate for proposed Rule 18a-4,¹¹⁷⁶ the burden imposed by paragraph (f) of Rule 17a-11, as proposed to be amended, is the requirement to notify the Commission when the firm fails to act in accordance with proposed Rule 18a-4. Given the similarity in the rules, the Commission estimates that each required notice would take one hour to prepare and file.¹¹⁷⁷ Based on Commission experience with the number of notices filed under current Rule 17a-11,¹¹⁷⁸ the Commission estimates that 100 notices would be filed each year under paragraph (f) of Rule 17a-11, as proposed to be amended, resulting in an industry-wide ongoing burden of 100 hours per year.¹¹⁷⁹

The Commission proposes to redesignate paragraph (f) of Rule 17a-11 as paragraph (g) and to require a broker-dealer's national securities exchange ("NSE") or national securities association ("NSA") to notify the Commission if it learns that the broker-dealer failed to provide a notice required under any paragraph of Rule 17a-11 (instead of just paragraphs (b) through (e) of Rule 17a-11).¹¹⁸⁰ Thus, NSEs and NSAs would be subject to new burdens to file a delinquent broker-dealer's notices under new paragraphs (e) (liquidity stress test) and (f) (failure to deposit in Rule 18a-4 account). After considering the similar Rule 17a-11 requirement, the Commission estimates that each required notice would take one hour to prepare and file.¹¹⁸¹ Based on

¹¹⁷⁵ See paragraph (f) of Rule 17a-11, as proposed to be amended.

¹¹⁷⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70297-70299.

¹¹⁷⁷ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

¹¹⁷⁸ See id. (noting that in 2011, the Commission received approximately 465 notices under Rule 17a-11).

¹¹⁷⁹ 100 notices/year x 1 hour/notice = 100 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁸⁰ See paragraph (g) of Rule 17a-11, as proposed to be amended.

¹¹⁸¹ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

Commission experience with the number of notices currently filed by NSEs and NSAs, the Commission estimates that ten notices would be filed pursuant to the amendment to paragraph (g) of Rule 17a-11, as proposed to be amended, resulting in an estimated industry-wide ongoing burden of 10 hours per year.¹¹⁸²

Estimated Hours and Costs of Proposed Rule 18a-8

Proposed Rule 18a-8 would require non-broker-dealer SBSs and non-broker-dealer MSBSs to notify the Commission of certain indicia of their financial condition.¹¹⁸³ The Commission estimates that each Rule 18a-8 notice would take approximately fifty-five minutes to prepare and file, in contrast to its estimate that a Rule 17a-11 notice would take one hour to prepare and file,¹¹⁸⁴ because stand-alone SBSs and stand-alone MSBSs do not have a DEA with which to file a copy of the Rule 17a-11 notice and bank SBSs and bank MSBSs are not required to file the Rule 17a-11 notice with their prudential regulator.¹¹⁸⁵

The Commission estimates that it would receive approximately five Rule 18a-8 notices per year, based on the substantially smaller pool of possible respondents, as compared with current Rule 17a-11. Under current Rule 17a-11, there are approximately 4,327 possible respondents – 4,545 registered broker-dealers, minus 218 broker-dealers registered pursuant to section 15(b)(11)(A) of the Exchange Act.¹¹⁸⁶ In contrast, the Commission estimates that there

¹¹⁸² 10 notices/year x 1 hour/notice = 10 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁸³ See proposed Rule 18a-8.

¹¹⁸⁴ See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-11.

¹¹⁸⁵ Compare paragraph (h) of Rule 17a-11, as proposed to be amended, with paragraph (h) proposed Rule 18a-8.

¹¹⁸⁶ Rule 17a-11 does not apply to a broker-dealer registered pursuant to section 15(b)(11)(A) of the Exchange Act (15 U.S.C. 78o(b)(11)(A)) that is not a member of either a national securities exchange or a national securities association. See paragraph (j) of Rule 17a-11, as proposed to be amended. The Commission estimates that there are approximately 4,327 broker-dealers subject to Rule 17a-11 after consulting with the

would be thirty-eight non-broker-dealer SBSBs and non-broker-dealer MSBSPs (twenty-five bank SBSBs, nine stand-alone SBSBs, and four stand-alone MSBSPs). Assuming that each of the five Rule 18a-8 notices takes fifty-five minutes to prepare and file, the Commission estimates proposed Rule 18a-8 would result in an industry-wide ongoing burden of 4.6 hours per year.¹¹⁸⁷

5. Proposed Rule 18a-9

Proposed Rule 18a-9, which is modeled on Rule 17a-13, would require stand-alone SBSBs to establish a securities count program.¹¹⁸⁸ As explained below, the Commission estimates that proposed Rule 18a-9 would impose an industry-wide initial burden of 225 hours and an industry-wide ongoing burden of 900 hours per year.

The current approved PRA estimate for Rule 17a-13 estimates a securities count program imposes an average ongoing cost of 100 hours per year.¹¹⁸⁹ The Commission is using this estimate, and therefore estimates that proposed Rule 18a-9 would impose an ongoing annual burden of 100 hours per stand-alone SBSB. The Commission estimates that there are nine stand-alone SBSBs, resulting in an estimated industry-wide ongoing burden of 900 hours per year.¹¹⁹⁰

The Commission also estimates that proposed Rule 18a-9 would impose an initial burden of twenty-five hours per firm. The records required by proposed Rule 18a-9 should already be recorded by the systems implemented under proposed Rules 18a-5 and 18a-6, and accordingly,

National Futures Association (4,545 registered broker-dealers – 218 broker-dealers registered pursuant to section 15(b)(11)(A) of the Exchange Act = 4,327 Rule 17a-11 respondents).

¹¹⁸⁷ 5 notices/year x (55 minutes/notice / 60 minutes/hour) = 4.6 hours/year. These internal hours likely would be performed by a compliance manager.

¹¹⁸⁸ See proposed Rule 18a-9.

¹¹⁸⁹ See Commission, Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-13 (May 3, 2011), available at <http://www.reginfo.gov/public/do/DownloadDocument?documentID=245864&version=1>.

¹¹⁹⁰ 100 hours/year x 9 stand-alone SBSBs = 900 hours/year. These internal hours likely would be performed by an operations specialist.

the resulting initial burden is largely already accounted for under these rules.¹¹⁹¹ However, the Commission estimates that the initial cost to establish procedures for conducting the securities count program, including identifying the persons involved in the program, would create an initial burden of approximately twenty-five hours per stand-alone SBSD, or 225 hours for the estimated nine stand-alone SBSDs.¹¹⁹²

E. Collection of Information Is Mandatory

The collections of information pursuant to the proposed amendments and new rules are mandatory, as applicable, for broker-dealers, SBSDs, and MSBSPs.

F. Confidentiality

The broker-dealer annual reports filed with the Commission are not confidential, except that if the statement of financial condition is bound separately from the balance of the annual reports, and each page of the balance of the annual reports is stamped "confidential," then the balance of the annual reports shall be deemed confidential to the extent permitted by law.¹¹⁹³ Subject to certain exceptions,¹¹⁹⁴ if there are material weaknesses, the accountant's report on the compliance report must be made available for customers' inspection and, consequently, it would not be deemed confidential.¹¹⁹⁵ Subject to certain exceptions,¹¹⁹⁶ a broker-dealer must furnish to its customers its unaudited financial statements,¹¹⁹⁷ and must provide annually a balance sheet with appropriate notes prepared in accordance with generally accepted accounting principles and

¹¹⁹¹ However, the Commission assumes that stand-alone SBSDs and stand-alone MSBSPs do not currently have a securities count program in place.

¹¹⁹² 25 hours x 9 stand-alone SBSDs = 225 hours. These internal hours likely would be performed by a senior operations manager.

¹¹⁹³ See paragraph (e)(3) of Rule 17a-5, as proposed to be amended.

¹¹⁹⁴ See paragraph (c)(1)(i) through (iii) of Rule 17a-5, as proposed to be amended.

¹¹⁹⁵ See paragraph (c)(2)(iv) of Rule 17a-5, as proposed to be amended.

¹¹⁹⁶ See paragraph (c)(1)(i)-(iii) of Rule 17a-5, as proposed to be amended.

¹¹⁹⁷ See paragraph (c)(3) of Rule 17a-5, as proposed to be amended.

which must be audited if the broker-dealer is required to file audited financial statements with the Commission.¹¹⁹⁸

The stand-alone SBSD and stand-alone MSBSP annual reports filed with the Commission are not confidential, except that if the statement of financial condition is bound separately from the balance of the annual reports, and each page of the balance of the annual reports is stamped "confidential," then the balance of the annual reports shall be deemed confidential to the extent permitted by law.¹¹⁹⁹ Stand-alone SBSDs and stand-alone MSBSPs must also make publicly available on their websites audited and unaudited financial statements, and also make these documents available in writing, upon request, to any person that has a security-based swap account.¹²⁰⁰ A stand-alone SBSD would also be required to disclose on its website at the same time: (1) a statement of the amount of the firm's net capital and required net capital and other information, if applicable, related to the firm's net capital;¹²⁰¹ and (2) if, in connection with the firm's most recent annual reports, the report of the independent public accountant identifies one or more material weaknesses, a copy of the report.¹²⁰²

With respect to the other information collected under the proposed amendments and proposed rules, the firm can request the confidential treatment of the information.¹²⁰³ If such a

¹¹⁹⁸ See paragraph (c)(2)(i) of Rule 17a-5, as proposed to be amended.

¹¹⁹⁹ See paragraph (d)(2) of proposed Rule 18a-7.

¹²⁰⁰ See paragraph (b) of proposed Rule 18a-7.

¹²⁰¹ See paragraph (b)(1)(ii) of proposed Rule 18a-7.

¹²⁰² See paragraphs (b)(1)(iii) of proposed Rule 18a-7.

¹²⁰³ See 17 CFR 200.83. Information regarding requests for confidential treatment of information submitted to the Commission is available on the Commission's website at <http://www.sec.gov/foia/howfo2.htm#privacy>.

confidential treatment request is made, the Commission anticipates that it will keep the information confidential subject to applicable law.¹²⁰⁴

G. Retention Period for Recordkeeping Requirements

Rule 17a-4, as proposed to be amended, specifies the required retention periods for a broker-dealer.¹²⁰⁵ Proposed Rule 18a-6 specifies the required retention periods for non-broker-dealer SBSs and non-broker-dealer MSBSs.¹²⁰⁶ Many of the required records must be retained for three years; certain other records must be retained for longer periods.¹²⁰⁷

H. Request for Comment

Pursuant to 44 U.S.C. 3306(c)(2)(B), the Commission requests comment on the proposed collections of information in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;
- Evaluate the accuracy of the Commission's estimates of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- Evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

¹²⁰⁴ See, e.g., 5 U.S.C. 552 *et seq.*; 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

¹²⁰⁵ See Rule 17a-4, as proposed to be amended.

¹²⁰⁶ See proposed Rule 18a-6.

¹²⁰⁷ See Rule 17a-4, as proposed to be amended; proposed Rule 18a-6.

1. The Commission does not expect any banks to register with the Commission as MSBSPs. Is this expectation correct? If not, please provide a suggested estimate and empirical support for it.
2. The Commission estimates that 26 FCMs will register with the Commission as SBSDBs or MSBSPs – 16 broker-dealer SBSDBs, 9 stand-alone SBSDBs, and 1 broker-dealer MSBSP. Is this estimate accurate? If so, provide empirical support for the Commission's estimate. If not, please provide a suggested estimate and empirical support for it.
3. The Commission believes that broker-dealers do not rely on paragraph (b)(2) of Rule 17a-3, which exempts from Rule 17a-3 transactions cleared by a bank if the bank keeps the requisite records for the broker-dealer.¹²⁰⁸ Is this correct? If not, please provide the estimated burden associated with the Commission's proposal to eliminate paragraph (b)(2) of Rule 17a-3.
4. Do stand-alone SBSDBs and stand-alone MSBSPs already have record making, record preservation, and reporting systems in place? If so, please identify them so they can be taken into account in the Commission's burden estimates under proposed Rules 18a-5 through 18a-9.
5. The Commission believes there is no burden associated with its proposed amendment to paragraph (b)(1) of Rule 17a-4, which would add a cross-reference to paragraph (a)(11) of Rule 17a-3, as proposed to be amended (regarding proof of money balances). Is this estimate reasonable? Explain why or why not.

Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the

¹²⁰⁸

See 17 CFR 240.17a-3(b)(2).

Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Kevin M. O'Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-05-14. OMB is required to make a decision concerning the collections of information between thirty and sixty days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within thirty days of this publication. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-05-14, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549.

V. ECONOMIC ANALYSIS

A. Introduction

The Commission is sensitive to the costs and benefits of its rules. Some of these costs and benefits stem from statutory mandates, while others are affected by the discretion exercised in implementing the mandates. The following economic analysis seeks to identify and consider the benefits and costs – including the effects on efficiency, competition, and capital formation – that would result from the proposed new recordkeeping, reporting, notification, and securities count rules for stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs and from the proposed amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11. The costs and benefits considered in proposing these new rules and amendments are discussed below and have informed the policy choices described throughout this release.

As discussed more fully in section II. above, pursuant to sections 15F and 17(a) of the Exchange Act, the Commission is proposing to amend Rules 17a-3, 17a-4, 17a-5, and 17a-11 to

establish recordkeeping, reporting, and notification requirements for broker-dealer SBSDs and broker-dealer MSBSPs to account for their security-based swap activities.¹²⁰⁹ Pursuant to section 15F(f) of the Exchange Act, the Commission is proposing new Rules 18a-5 through 18a-9 to establish recordkeeping, reporting, and notification requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, and securities count requirements for stand-alone SBSDs. Finally, pursuant to sections 15F(f) and 17(a) of the Exchange Act, the Commission is proposing new Form SBS that would be used by all types of SBSDs and MSBSPs to report financial information and, in the case of broker-dealer SBSDs and broker-dealer MSBSPs, replace their use of Part II, Part IIA, Part IIB, or Part II CSE of the FOCUS Report. The Commission believes these proposed rules and rule amendments will help regulators determine whether relevant market participants comply with the proposed capital, margin, and segregation requirements.¹²¹⁰ Additionally, the Commission is proposing technical amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11, which will apply to all registered broker-dealers.

With regard to the proposed rules and rule amendments relating to security-based swap recordkeeping and reporting, the baseline for the economic analysis is the OTC derivatives markets as they exist today. The baseline includes any recordkeeping and reporting rules currently applicable to participants in the OTC derivatives market including applicable rules previously adopted by the Commission¹²¹¹ but excluding the rules proposed here. The current

¹²⁰⁹ In addition, paragraph (a)(5) of Rule 17a-5, as proposed to be amended, and paragraph (e) of Rule 17a-11, as proposed to be amended, would require ANC broker-dealers to make additional reports related to the liquidity stress test conducted pursuant to paragraph (f) of Rule 15c3-1. The Commission is also proposing certain other amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11, as discussed above.

¹²¹⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

¹²¹¹ The Commission notes that it has temporarily excluded security-based swaps from the definition of "security." See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in

OTC derivatives market participants and the current reporting and recordkeeping regimes for those entities are discussed more fully below. With respect to the proposed technical amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11, the baseline for purposes of this economic analysis is the current recordkeeping and reporting regime for broker-dealers under such rules.¹²¹²

While the Commission does not have comprehensive information on the U.S. OTC derivatives markets, the Commission is using the limited data currently available in considering the effects of the proposals.¹²¹³ The Commission requests that commenters identify sources of data and information as well as provide data and information to assist the Commission in analyzing the economic consequences of the proposed rules. The Commission also requests comment on all aspects of this initial economic analysis, including on whether the analysis has: (1) identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed new rules and rule amendments.

The sections below present an overview of the OTC derivatives markets, a discussion of the general costs and benefits of the proposed recordkeeping and reporting requirements, and a

Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, 76 FR 39927; Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, 78 FR 10218 (extending exemptive relief through February 11, 2014). Thus, for purposes of the Commission's baseline analysis for broker-dealers, security-based swap activities would be excluded.

¹²¹² See 17 CFR 240.17a-3; 17 CFR 240.17a-4; 17 CFR 240.17a-5; 17 CFR 240.17a-11.

¹²¹³ Information that is available for the purposes of this economic analysis includes an analysis of the market for single-name credit default swaps performed by the Commission's Division of Economic and Risk Analysis (f/k/a the "Division of Risk, Strategy, and Financial Innovation"). See Memorandum from Commission's Division of Risk, Strategy, and Financial Innovation to File (Mar. 15, 2012), available at <http://www.sec.gov/comments/s7-39-10/s73910-154.pdf> ("CDS Data Analysis").

discussion of the costs and benefits of each proposed amendment and new rule. The Economic Analysis also includes a discussion of the potential effects of the proposed amendments and new rules on competition, efficiency, and capital formation. The final section of the Economic Analysis consists of a discussion of implementation considerations.

B. Baseline of Economic Analysis

1. OTC Derivatives Market

As stated above, to assess the costs and benefits of these rules, a baseline must be established against which the rules may be evaluated. For the purposes of this economic analysis, the baseline is the OTC derivatives markets¹²¹⁴ as they exist today, including applicable rules adopted by the Commission but excluding the rules proposed here.¹²¹⁵ The markets as they exist today are dominated, both globally and domestically, by a small number of firms, generally entities affiliated with or within large commercial banks.¹²¹⁶

The OTC derivatives markets have been described as opaque because, for example, transaction-level data about OTC derivatives trading generally is not publicly available.¹²¹⁷ This

¹²¹⁴ OTC derivatives may include forwards, swaps, and options on foreign exchange, and interest rate, equity, and commodity derivatives.

¹²¹⁵ The baseline, however, for the proposed amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11 is the current recordkeeping and reporting regime for broker-dealers under these rules.

¹²¹⁶ See, e.g., Bank for International Settlements ("BIS"), Statistical Release: OTC derivatives statistics at end-June 2013 (November 2013), available at http://www.bis.org/publ/otc_hy1311.pdf. See also ISDA Margin Survey 2012.

¹²¹⁷ See Orice M. Williams, Director, Financial Markets and Community Investment, General Accountability Office, Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps, GAO-09-397T, 2, 5, 27 (Mar. 2009), available at <http://www.gao.gov/new.items/d09397t.pdf>. See also Robert E. Litan, The Brookings Institution, The Derivatives Dealers' Club and Derivatives Market Reform: A Guide for Policy Makers, Citizens and Other Interested Parties 15-20 (Apr. 7, 2010), available at http://www.brookings.edu/~media/research/files/papers/2010/4/07%20derivatives%20litan/0407_derivatives_litan.pdf; Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306, 77354 (Dec. 10, 2010); International Organization of Securities Commissions, The Credit Default Swap Market, Report FR05/12 (June 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf> (stating although the amount of public information on credit default swaps has increased over recent years, the credit default swap market is still quite opaque).

economic analysis is supported, where possible, by data currently available to the Commission from the Depository Trust & Clearing Corporation Trade Information Warehouse (“DTCC-TIW”). This evaluation takes into account data regarding the security-based swap market and especially data regarding the activity – including activity that may be suggestive of dealing behavior – of participants in the single-name credit default swap market.¹²¹⁸ While a large segment of the security-based swap market is comprised of credit default swaps, these derivatives do not comprise the entire security-based swap market.

Available information about the global OTC derivatives markets suggests that swap transactions, in contrast to security-based swap transactions, dominate trading activities, notional amounts, and market values.¹²¹⁹ For example, the BIS estimates that the total notional amounts outstanding and gross market value of global OTC derivatives were over \$693 trillion and \$20.2 trillion, respectively, as of the end of June 2013.¹²²⁰ Of these totals, the BIS estimates that foreign exchange contracts, interest rate contracts, and commodity contracts comprised approximately 95% of the total notional amount and 93% of the gross market value.¹²²¹ Credit default swaps, including index credit default swaps, comprised approximately 3.5% of the total notional amount and 3.6% of the gross market value. Equity-linked contracts, including forwards, swaps, and options, comprised approximately an additional 1.0% of the total notional amount and 3.5% of the gross market value.¹²²²

¹²¹⁸ See CDS Data Analysis.

¹²¹⁹ See BIS Statistical Release: OTC derivatives statistics at end-June 2013 (reflecting data reported by central banks in thirteen countries: Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the U.S.).

¹²²⁰ Id. at 5.

¹²²¹ Id.

¹²²² Id. Similarly, the OCC has found that interest rate products comprised 81% of the total notional amount of OTC derivatives held by bank dealers whereas credit derivative contracts comprised 5%. See OCC,

Security-based swaps represent a relatively small subset of the overall global OTC derivatives market.¹²²³ Consistent with the Commission's authority over this subset of the OTC derivatives market,¹²²⁴ the recordkeeping, reporting, and notification requirements under proposed Rules 18a-5 through 18a-9 would apply only to those firms that participate in the security-based swap markets (although some of these firms may be dually-registered with the CFTC or the prudential regulators and thus may be subject to the recordkeeping and reporting rules of the CFTC and the prudential regulators governing swaps generally).¹²²⁵ In addition, although the proposed recordkeeping, reporting, and notification requirements apply to all security-based swaps, not just single-name credit default swaps, the data on single-name credit default swaps are currently sufficiently representative of the market to help inform this economic analysis because when measured by notional value, single-name credit default swaps account for 95% of all SBS transactions.¹²²⁶ The majority of these single-name credit default swaps, both in

Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2013, available at <http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq313.pdf>.

¹²²³ For example, as of the end of June, 2013, BIS reports that the global notional amount outstanding of OTC derivatives was \$692,908 billion. Interest rate contracts, which generally are not security-based swaps, comprised approximately 83.31% of the overall OTC derivatives market. Foreign exchange contracts, another type of OTC derivative which generally is not a security-based swap, comprised another 11.69% of the overall derivatives market. See BIS Statistical Release: OTC derivatives statistics at end-June 2013, p. 5.

¹²²⁴ See 15 U.S.C. 78o-10(f)(1) and (2).

¹²²⁵ See, e.g., Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps (Final Rule), 77 FR 35200 (June 12, 2012); Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128 (Apr. 3, 2012).

¹²²⁶ See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR at 30636. See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208.

terms of aggregate total notional amount and total volume by product type reference corporate and sovereign entities.¹²²⁷

While the number of transactions in single-name credit default swaps is larger than the number of index credit default swaps, the aggregate total notional amount of index credit default swaps exceeds the notional amount of single-name credit default swaps.¹²²⁸ For example, the total aggregate notional amount for single-name credit default swaps was \$6.2 trillion, while the aggregate total notional amount for index credit default swaps was \$16.8 trillion over the sample period of January 1, 2011 through December 31, 2011. For the same sample period, however, single-name credit default swaps totaled 69% of transactional volume, while index credit default swaps comprised 31% of the total transactional volume.¹²²⁹ The majority of trades in both notional amount and volume for both single-name and index credit default swaps over the 2011 sample period were new trades in contrast to assignments, increases, terminations or exits.¹²³⁰ The analysis of the 2011 data further shows that, as measured by total notional amount and total volume, the majority of single-name and index credit default contracts have a tenor of five years.¹²³¹ In addition, the data from the sample period indicates that the geographical distribution of counterparties' parent country domiciles in single name contracts are concentrated in the U.S., United Kingdom, and Switzerland.¹²³²

¹²²⁷ Data compiled by the Commission's Division of Economic and Risk Analysis on credit default transactions from the DTCC-TIW from January 1, 2011 through December 31, 2011. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital for Broker-Dealers, 77 FR at 70301.

¹²²⁸ Id. This data also shows the average mean and median single-name and index credit default swap notional transaction size is \$6.47 million and \$4.12 million, and \$39.22 million and \$14.25 million, respectively.

¹²²⁹ Id.

¹²³⁰ Id.

¹²³¹ Id.

¹²³² Id.

As described more fully in the CDS Data Analysis,¹²³³ based on 2011 transaction data, Commission staff identified entities currently transacting in the credit default swap market that may register as SBSDs by analyzing various criteria of their dealing activity. The results suggest that there is currently a high degree of concentration of potential dealing activity in the single-name credit default swap market. For example, using the criterion that dealers are likely to transact with many counterparties who themselves are not dealers, the analysis of the 2011 data shows that only 28 out of 1,084 market participants have three or more counterparties that themselves are not recognized as dealers by ISDA.¹²³⁴ In addition, the analysis suggests that dealers appear, based on the percentage of trades between buyer and seller principals, in the majority of all trades on either one or both sides in single-name and index credit default swaps.¹²³⁵ Additionally, according to the OCC, at the end of the first quarter of 2012, derivatives activity in the U.S. banking system continues to be dominated by a small group of large financial institutions. Four large commercial banks represent 93% of the total banking industry notional amounts and 81% of industry net current credit exposure.¹²³⁶

This concentration to a large extent appears to reflect the fact that those larger entities are well-capitalized and therefore possess competitive advantages in engaging in OTC security-based swap dealing activities by providing potential counterparties with adequate assurances of

¹²³³ See CDS Data Analysis.

¹²³⁴ Id. at Table 3c. The analysis of this transaction data is imperfect as a tool for identifying dealing activity, given that the presence or absence of dealing activity ultimately turns upon the relevant facts and circumstances of an entity's security-based swap transactions, as informed by the dealer-trader distinction. Criteria based on the number of an entity's counterparties that are not recognized as dealers nonetheless appear to be useful for identifying apparent dealing activity in the absence of full analysis of the relevant facts and circumstances, given that engaging in security-based swap transactions with non-dealers would be consistent with the conduct of seeking to profit by providing liquidity to others, as anticipated by the dealer-trader distinction. See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 FR at 30599 (discussing the dealer-trader distinction).

¹²³⁵ See CDS Data Analysis.

¹²³⁶ See OCC, Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2013, p.1.

financial performance.¹²³⁷ Also, the high barriers to entry indicate that only a limited number of entities conduct business in this space.

Other than OTC derivatives dealers, which are subject to significant limitations on their activities, broker-dealers historically have not participated in a significant way in security-based swap trading for at least two reasons. First, because the Exchange Act has not previously defined security-based swaps as “securities,” they have not been required to be traded through registered broker-dealers.¹²³⁸ And second, a broker-dealer engaging in security-based swap activities is currently subject to existing regulatory requirements, including capital, margin, segregation, recordkeeping, reporting, notification, and securities count requirements. Specifically, the existing broker-dealer capital requirements make it relatively costly to conduct these activities in broker-dealers.¹²³⁹ Instead of occurring at broker-dealers, security-based swap activities are currently mostly concentrated in entities that are affiliated with broker-dealers, but not in broker-dealers themselves.¹²⁴⁰

End users enter into OTC derivatives transactions to take investment positions or to hedge commercial and financial risk. These non-dealer end users of OTC derivatives are, for example, commercial companies, governmental entities, financial institutions, and investment vehicles.¹²⁴¹ Available data suggests that the largest end users of credit default swaps are, in

¹²³⁷ See, e.g., Craig Pirrong, Rocket Science, Default Risk and The Organization of Derivatives Markets, Working Paper 17–18 (2006), available at <http://www.cba.uh.edu/spirrong/Derivorg1.pdf> (noting that counterparties seek to reduce risk of default by engaging in credit derivative transactions with well-capitalized firms). See also Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 FR at 30739–30742.

¹²³⁸ See 15 U.S.C. 78c(a)(10) and (a)(68) (defining “security” and “security-based swap”, respectively).

¹²³⁹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70217–70257.

¹²⁴⁰ See ISDA Margin Survey 2012.

¹²⁴¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital for Broker-Dealers, 77 FR at 70302.

descending order, hedge funds, asset managers, and banks, which may have a commercial need to hedge their credit exposures against a wide variety of entities or may take an active view on credit risk.¹²⁴² Based on the available data, the Commission further estimates that these end users currently participate in the security-based swap markets on a very limited basis.¹²⁴³ Finally, this baseline will be further discussed in the applicable sections of the release below.

Request for Comment

The Commission generally requests comment about its preliminary estimates of the scale and composition of the OTC derivatives market, including the relative size of the security-based swap segment of that market. The Commission also requests comment on the Commission's understanding of which entities are engaged in the OTC derivatives market, as well as the business practices of broker-dealer, bank, and stand-alone SBSs and MSBSs currently engaged in the OTC derivatives markets. In addition, the Commission requests that commenters provide data and sources of data to quantify:

1. The average daily and annual volume of OTC derivatives transactions;
2. The volume of transactions in each class of OTC derivatives (e.g., interest rate swaps, index credit default swaps, single-name credit default swaps, currency swaps, commodity swaps, and equity-based swaps);
3. The total notional amount of all pending swap transactions;
4. The total gross exposure of all pending swap transactions;
5. The total notional amount of all pending security-based swap transactions;
6. The total gross exposure of all pending security-based swap transactions;

¹²⁴² See CDS Data Analysis.

¹²⁴³ Id.

7. The types and numbers of dealers in OTC derivatives (e.g., banks, broker-dealers, unregulated entities);
8. The types and numbers of dealers in OTC derivatives that engage in both a swap and security-based swap business;
9. The types and numbers of dealers in OTC derivatives that engage only in a swap business;
10. The types and numbers of dealers in OTC derivatives that engage only in a security-based swap business;
11. The current recordkeeping practices with respect to security-based swap and swap transactions;
12. The current reporting practices with respect to swap transactions;
13. The current securities count practices with respect to OTC derivatives participants; and
14. The current financial reporting practices of OTC derivatives participants.

2. OTC Derivatives Market Participants and Broker-Dealers

The Commission has not promulgated final registration rules for SBSDs and MSBSPs. Therefore, there are no entities currently registered as SBSDs or MSBSPs. As discussed above, the Commission anticipates that certain entities (stand-alone firms, banks, and registered broker-dealers) may register as SBSDs or MSBSPs, but the number and type of these registrants is uncertain. Below, the Commission has summarized the current recordkeeping practices of these entities, although as noted below, the Commission does not have information regarding the practices of some of these entities. The Commission also has provided below an overview of the entities registered with the Commission as broker-dealers.

a. Stand-Alone SBSDs and Stand-Alone MSBSPs

Currently, there are firms that are neither banks nor broker-dealers that participate in the market for security-based swaps. For these firms, the economic baseline would be the reports and records these firms currently generate in the ordinary course of their business. The Commission believes that firms engaged in the security-based swap market would produce financial reports that are included in the financial reports it is proposing, such as a balance sheet and an income statement quarterly and at year end, as a part of ordinary prudent business practices. Such firms may not, however, produce annual audited financial statements. The Commission also believes that firms engaged in the security-based swap business would need, as a matter of prudent business practice, to maintain records documenting the firm's derivatives positions. Further, the Commission would expect that these firms would maintain these records for the duration they held a given position and for some period of time thereafter. However, the Commission does not believe that these firms would necessarily have any regulatory reporting activities. In sum, the baseline for nonbank and non-broker-dealer firms would be the recordkeeping, record retention, and financial reporting activities (if any) those firms currently undertake. Given that the Commission has not previously regulated these firms, the Commission does not have information regarding the recordkeeping and reporting costs these nonbank and non-broker-dealer firms would presently incur in the ordinary course of business. Moreover, while the Commission has estimated the current costs of recordkeeping and reporting for broker-dealer and banks below, the Commission does not believe these nonbank and non-broker-dealer firms are currently subject to analogous recordkeeping and reporting requirements. As noted above, the Commission believes that these firms would, however, as a matter of routine business practice maintain some records documenting their business activities. Any new costs imposed by the proposed rules would be incremental to costs currently being incurred by these entities. In

order to help the Commission assess the costs associated with the proposed recordkeeping and reporting requirements, and the extent to which the proposed recordkeeping and reporting rules add costs above those already incurred by these firms in the ordinary course of business, the Commission requests comment. Specific cost estimates would be particularly helpful to the Commission's analysis.

b. Bank Security-Based Swap Dealers and Bank Major Security-Based Swap Participants

Banks are already subject to recordkeeping and retention requirements by the prudential regulators.¹²⁴⁴ In addition, banks must file financial statements and supporting schedules known as "call reports" with their prudential regulator.¹²⁴⁵ The Commission believes that the most common form of call report for a bank that would register as an SBSD or MSBSP is FFIEC Form 031.¹²⁴⁶ Like the FOCUS Report, FFIEC Form 031 elicits financial and operational information about a bank, which is entered into uniquely numbered line items. A bank must report detail about its assets, liabilities, and equity capital on Schedule RC to FFIEC Form 031.¹²⁴⁷ A bank must report detail about its regulatory capital on Schedule RC-R to FFIEC Form 031.¹²⁴⁸ The information elicited on Schedule RC-R is designed to facilitate an analysis of the

¹²⁴⁴ See, e.g., 12 CFR 12.3 (Department of Treasury); 12 CFR 219.21 *et seq.* (FDIC); 12 CFR 344.4 (FDIC).

¹²⁴⁵ See 12 U.S.C. 324; 12 U.S.C. 1817; 12 U.S.C. 161; 12 U.S.C. 1464.

¹²⁴⁶ FFIEC Form 031 is filed by banks with domestic and foreign offices, which the Commission believes will characterize most bank SBSDs.

¹²⁴⁷ See FFIEC Form 031, Schedule RC, Balance Sheet, Lines 1–29. Schedule RC also has a "Memoranda" section that which elicits information about bank's external auditors and fiscal year end date. See FFIEC Form 031, Schedule RC, Balance Sheet, Memoranda, Lines 1–2.

¹²⁴⁸ See FFIEC Form 031, Schedule RC-R, Regulatory Capital, Lines 1–62. Schedule RC-R also has a "Memoranda" section that elicits detail about derivatives. See FFIEC Form 031, Schedule RC-R, Regulatory Capital, Memoranda, Lines 1–2.

bank's regulatory capital. A bank must report detail about its income (loss) and expenses on Schedule RI to FFIEC Form 031.¹²⁴⁹

The Commission has estimated the cost of the existing recordkeeping, record retention, reporting, and notification requirements that are applicable to nationally chartered banks under existing regulations issued by the OCC. The Commission arrived at the estimate by examining the universe of existing PRA collections to which national banks are subject and selecting those collections which represent regulations that are analogous to the recordkeeping, record retention, reporting, and notification rules the Commission is proposing herein.¹²⁵⁰ The Commission then estimated that reporting burdens generate approximately \$79/hour of cost for national banks and that recordkeeping burdens generate approximately \$30/hour of cost for national banks.¹²⁵¹ The Commission estimates that national banks currently incur \$54,120,368 of costs to comply with the OCC's financial reporting, notification and recordkeeping rules.¹²⁵² The OCC's rules

¹²⁴⁹ See FFIEC Form 031, Schedule RI, Income Statement, Lines 1–14. Schedule RI also has a "Memoranda" section that elicits further detail about income (loss). See FFIEC Form 031, Schedule RI, Income Statement, Memoranda, Lines 1–14.

¹²⁵⁰ PRA collections for OCC-regulated national banks, together with PRA collections for other federal regulatory agency rules, are available at www.reginfo.gov/public/do/PRAMain.

¹²⁵¹ This assumption is derived from OCC staff's description of the hourly costs it estimates in connection with Paperwork Reduction Act burdens. For the purposes of this Economic Analysis, the Commission assumes that reporting burdens will be performed 5% by clerical staff at \$20 an hour, 10% by managerial or technical staff at \$40 an hour, 55% by senior management at \$80 an hour, and 30% by legal counsel at \$100 an hour, which, in the aggregate, equals \$79 an hour. The Commission assumes that recordkeeping burdens will be performed 70% by clerical staff at \$20 an hour, 20% by managerial or technical staff at \$40 an hour, and 10% by senior management at \$80 an hour, which in the aggregate, equals \$30 an hour.

¹²⁵² The Commission derived the estimates of the hourly burden associated with these OCC rules from the number of hours approved for information collection purposes by the Office of Management and Budget. See the chart below for a representation of the calculation methodology:

Reporting / Recordkeeping	Annual Hourly Industry Burden	Compensation Rate (per hour)	Estimated Annual Cost
Interagency Call Report (FFIEC 031 and 041)	406,141	\$79	\$32,085,139
Foreign Branch Call Report (FFIEC 041)	4,651	\$79	\$367,429
Country Exposure Report (FFIEC 009)	8,384	\$79	\$662,336
Exchange Act Disclosures Reported to the OCC	523	\$79	\$32,785

generally relate to banking activities, not securities and security-based swap activities. The Commission thus recognizes that some of the costs reflected in the OCC's rules may not be analogous to costs that may be imposed by the Commission's proposed rules. Nonetheless, these cost estimates may help provide context and cost ranges with respect to the nationally chartered banks impacted by the Commission's proposed rules.

c. Entities Registered as Broker-Dealers

As of April 1, 2013, there were 4,545 broker-dealers registered with the Commission. The broker-dealers registered with the Commission vary significantly in terms of their size, business activities, and the complexity of their operations.¹²⁵³ The Commission has previously estimated that as of December 31, 2011, nine broker-dealers dominate the broker-dealer industry, holding over half of all capital held by broker-dealers.¹²⁵⁴ However, other than OTC derivatives

Recordkeeping Requirements for Securities Transactions	6,944	\$30	\$208,320
Disclosure of Financial and Other Information	669	\$79	\$52,851
Interagency Guidance on Asset Securitization Activities	778	\$30	\$23,340
Advanced Capital Adequacy Framework Reporting	137,500	\$79	\$10,862,500
Liquidity Risk Report	43,992	\$79	\$3,475,368
General Reporting and Recordkeeping by Savings Associations	61,362	\$30	\$1,840,860
Notice or Application for Capital Distributions	546	\$79	\$43,134
Annual Stress Test Rule and Stress Test Reporting Templates	73,876	\$79	\$5,836,204
Recordkeeping and Disclosure Provisions Associated with Stress Testing Guidance	16,120	\$30	\$483,600
Total Costs			\$55,614,969

¹²⁵³ See Broker-Dealer Reports, 78 FR at 51967.

¹²⁵⁴ See Broker-Dealer Reports, 78 FR at 51968.

dealers, which are subject to significant limitations on their activities, broker-dealers historically have not participated in a significant way in security-based swap trading.¹²⁵⁵

i. Rules 17a-3 and 17a-4

The Commission is proposing amendments to Rules 17a-3 and 17a-4 to establish additional recordkeeping requirements for broker-dealer SBSDs, broker-dealer MSBSPs,¹²⁵⁶ and broker-dealers that conduct security-based swap activities but are not registered as SBSDs.¹²⁵⁷ The baseline for this economic analysis with respect to the proposed amendments to Rules 17a-3 and 17a-4 is the broker-dealer recordkeeping regime as it exists today.

Under current Rule 17a-3, broker-dealers must make and keep certain books and records.¹²⁵⁸ The Commission estimates that current Rule 17a-3 imposes \$191,858,085 of annual costs on broker-dealers.¹²⁵⁹ Current Rule 17a-4 requires that firms preserve the records made and kept under Rule 17a-3, as well as additional records, including written agreements, communications relating to its business as such, and records reflecting inputs into the FOCUS Report. The rule also establishes retention periods for all records required to be made under Rule 17a-3 and required to be preserved under Rule 17a-4, along with storage media requirements for those firms that preserve records electronically. The Commission estimates that

¹²⁵⁵ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70302.

¹²⁵⁶ See section II.A.2. of this release.

¹²⁵⁷ The proposed amendments to the recordkeeping and reporting rules would apply to all broker-dealers that conduct security-based swap activities. The de minimis exception provided in Exchange Act Rule 3a71-2 applies solely to registration as an SBSD. See 17 CFR 240.3a71-2(a)(1).

¹²⁵⁸ See 17 CFR 240.17a-3.

¹²⁵⁹ (2,449,755 hours x \$63/hour national hourly rate for a compliance clerk) + \$37,523,520 in external costs = \$191,858,085. See supra section IV.D.1. (PRA estimate of the total initial and annual recordkeeping and reporting burden for current Rule 17a-3).

current Rule 17a-4 imposes \$95,454,090 of annual costs on broker-dealers.¹²⁶⁰

ii. Rule 17a-5

The existing broker-dealer financial reporting requirements appear in Rule 17a-5. The baseline for this economic analysis with respect to the proposed amendments to Rules 17a-5 is the broker-dealer financial reporting requirements as they exist today (as recently amended). The Commission estimates that current Rule 17a-5 imposes \$210,776,086 of annual costs on broker-dealers.¹²⁶¹

Rule 17a-5, as recently amended, has two main elements: (1) broker-dealers must file periodic unaudited reports containing information about their financial and operational condition on a FOCUS Report; and (2) broker-dealers must annually file financial statements and certain reports and a report covering the financial statements and reports prepared by an independent public accountant registered with the PCAOB in accordance with PCAOB standards.¹²⁶² In addition to these two main elements, a few other aspects of Rule 17a-5 are described below.

a. Periodic Reports

Broker-dealers periodically report information about their financial and operational condition on the FOCUS Report Part II, Part IIA, Part IIB, or Part II CSE. Each version of the report is designed for a particular type of broker-dealer and the information to be reported is tailored to the type of broker-dealer. Specifically: (1) a broker-dealer that does not hold customer funds or securities completes and files the FOCUS Report Part IIA; (2) a broker-dealer that holds customer funds or securities completes and files the FOCUS Report Part II; (3) an

¹²⁶⁰ (1,154,430 hours x \$63/hour national hourly rate for a compliance clerk) + \$22,725,000 in external costs = \$95,454,090. See supra section IV.D.2. (PRA estimate of the total initial and annual recordkeeping and reporting burden for current Rule 17a-4).

¹²⁶¹ (734,294 hours x \$269/hour national hourly rate for a compliance manager) + \$13,251,000 in external costs = \$210,776,086. See supra section IV.D.3. (PRA estimate of the total initial and annual recordkeeping and reporting burden for current Rule 17a-5).

¹²⁶² Id. These requirements are described in more detail below.

OTC derivatives dealer completes and files the FOCUS Report Part IIB; and (4) an ANC broker-dealer completes and files the FOCUS Report Part II CSE. The FOCUS Report Part II CSE elicits the most detailed information of the four versions, including the most detail about a firm's derivatives activities.

b. Annual Audited Reports and Related Notifications

Under the recently adopted amendments to Rule 17a-5, a broker-dealer is required to, among other things, annually file reports with the Commission that are audited by a PCAOB-registered independent public accountant, disclose certain financial information to customers, notify the Commission of a change of accountant, and notify the Commission of its DEA's approval of a change in its fiscal year.¹²⁶³ The recent rule amendments also require the independent public accountant to notify the broker-dealer if the accountant discovers an instance of non-compliance with certain broker-dealer rules or determines that any material weakness exists.¹²⁶⁴

c. Customer Statements

Paragraph (c) of Rule 17a-5 requires, among other things, that certain broker-dealers annually send their customers audited and unaudited statements regarding their financial condition. A broker-dealer is exempt from sending the statement of financial condition to customers if the broker-dealer, among other things: (1) sends its customers semi-annual statements relating to the firm's net capital and, if applicable, the identification of any material weaknesses; and (2) makes the statement of financial condition described above available on the

¹²⁶³ See 17 CFR 240.17a-5(d), (g), and (n)(1). Paragraph (n)(2) of Rule 17a-5 requires that the notice contain a detailed explanation for the reasons for the change and requires that changes in the filing period for the annual reports be approved in writing by the broker-dealer's DEA.¹²⁶³

¹²⁶⁴ See Broker-Dealer Reports, 78 FR 51910.

broker-dealer's website home page and maintains a toll-free number that customers can call to request a copy of the statement.¹²⁶⁵

d. Additional ANC Broker-Dealer Reports

Paragraph (a)(6) of Rule 17a-5 requires ANC broker-dealers to periodically file certain reports with the Commission.¹²⁶⁶ The reports contain information related to the ANC broker-dealer's use of internal models to calculate market and credit risk charges when computing net capital.¹²⁶⁷

iii. Rule 17a-11

The existing broker-dealer notice requirements are contained in Rule 17a-11. The baseline for this economic analysis with respect to the proposed amendments to Rule 17a-11 is the broker-dealer notification requirements as they exist today. Rule 17a-11 specifies the circumstances under which a broker-dealer must notify the Commission and other securities regulators about its financial or operational condition, as well as the form that the notice must take.¹²⁶⁸ The Commission estimates that current Rule 17a-11 imposes \$119,167 of annual costs on broker-dealers in the aggregate.¹²⁶⁹

a. Failure to Meet Minimum Capital Requirements

Paragraph (b) of Rule 17a-11 requires a broker-dealer to notify the Commission if the firm's net capital or, if applicable, tentative net capital declines below the minimum amount

¹²⁶⁵ See 17 CFR 240.17a-5(c)(5).

¹²⁶⁶ See 17 CFR 240.17a-5(a)(6).

¹²⁶⁷ Id.

¹²⁶⁸ See 17 CFR 240.17a-11.

¹²⁶⁹ 443hours x \$269/hour national hourly rate for a compliance manager = \$119,167. See *supra* section IV.D.4. (PRA estimate of the total initial and annual recordkeeping and reporting burden for current Rule 17a-11).

required under Rule 15c3-1.¹²⁷⁰ Paragraph (b)(2) of Rule 17a-11 requires an OTC derivatives dealer or an ANC broker-dealer to also notify the Commission when its tentative net capital falls below the minimum required for these types of broker-dealers.¹²⁷¹

b. Early Warning of Potential Capital or Model Problem

Paragraph (b)(2) of Rule 17a-11 requires an OTC derivatives dealer or an ANC broker-dealer to also notify the Commission when its tentative net capital falls below the minimum required for these types of broker-dealers.¹²⁷² Paragraph (c) of Rule 17a-11 specifies four events that, if they occur, trigger a requirement that a broker-dealer send notice promptly (but within twenty-four hours) to the Commission.¹²⁷³ These notices are designed to provide the Commission with “early warning” that the broker-dealer may experience financial difficulty.¹²⁷⁴ The events triggering the early warning notification requirements are:

- The computation of a broker-dealer subject to the aggregate indebtedness standard of Rule 15c3-1 shows that the firm’s aggregate indebtedness is in excess of 1,200% of its net capital;¹²⁷⁵
- The computation of a broker-dealer which has elected to use the alternative standard of calculating net capital under Rule 15c3-1 shows that the firm’s net capital is less than 5% of aggregate debit items computed in accordance with Appendix A of Rule 15c3-3;¹²⁷⁶

¹²⁷⁰ See 17 CFR 240.17a-11(b).

¹²⁷¹ See 17 CFR 240.17a-11(b)(2).

¹²⁷² Id.

¹²⁷³ See 17 CFR 240.17a-11(c).

¹²⁷⁴ See Early Warning Rule, Securities Exchange Act Release No. 32586 (July 7, 1993), 58 FR 37655 (July 13, 1993).

¹²⁷⁵ See 17 CFR 240.17a-11(c)(1). As discussed above, for certain types of broker-dealers, the minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying a 15-to-1 aggregate indebtedness to net capital ratio. See 17 CFR 240.15c3-1(a)(1)(i). Consequently, requiring notification when a broker-dealer has a 12-to-1 aggregate indebtedness to net capital ratio provides notice before the firm reaches the minimum 15-to-1 requirement.

¹²⁷⁶ See 17 CFR 240.17a-11(c)(2). As discussed above, for certain types of broker-dealers, the minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying a 2% of aggregate debit items ratio. See 17 CFR 240.15c3-1(a)(1)(ii). Consequently,

- A broker-dealer's net capital computation shows that its total net capital is less than 120% of its required minimum level of net capital or of its required minimum level of tentative net capital, in the case of an OTC derivatives dealer;¹²⁷⁷
- With respect to an OTC derivatives dealer, the occurrence of the fourth and each subsequent backtesting exception under Appendix F of Rule 15c3-1 during any 250 business day measurement period.¹²⁷⁸

c. Failure to Make and Keep Current Books and Records

Paragraph (d) of Rule 17a-11 requires a broker-dealer that fails to make and keep current the books and records required under Rule 17a-3 to notify the Commission of this fact on the same day that the failure arises.¹²⁷⁹ The notice must specify the books and records which have not been made or which are not current.¹²⁸⁰ A broker-dealer is required to report to the Commission within 48 hours of the original notice what the broker or dealer has done or is doing to correct the situation.¹²⁸¹

d. Material Weakness

Paragraph (e) of Rule 17a-11 requires a broker-dealer to provide notification about a material weakness as that term is defined in Rule 17a-5.¹²⁸² Specifically, paragraph (e) provides that, whenever a broker-dealer discovers or is notified by an independent public accountant of a material weakness as defined in Rule 17a-5, the broker-dealer must: (1) give notice to the Commission within twenty-four hours of the discovery or notification of the material weakness;

requiring notification when a broker-dealer has net capital equal to 5% of aggregate debit items provides notice before the firm reaches the 2% minimum requirement.

¹²⁷⁷ See 17 CFR 240.17a-11(c)(3).

¹²⁷⁸ See 17 CFR 240.17a-11(c)(4).

¹²⁷⁹ See 17 CFR 240.17a-11(d).

¹²⁸⁰ Id.

¹²⁸¹ Id.

¹²⁸² See 17 CFR 240.17a-11(e). See also 17 CFR 240.17a-5(g).

and (2) transmit a report within forty-eight hours of the notice indicating what the broker-dealer has done or is doing to correct the situation.¹²⁸³

e. Failure to Make a Required Reserve Deposit

An additional broker-dealer notification is required under Exchange Act Rule 15c3-3, rather than Rule 17a-11. Specifically, under paragraph (i) of Rule 15c3-3, a broker-dealer is required to notify the Commission and its DEA if it fails to make a required deposit into its customer reserve account under Rule 15c3-3.¹²⁸⁴

C. ANALYSIS OF THE PROPOSED PROGRAM AND ALTERNATIVES

1. Overview – The Proposed Recordkeeping, Reporting, Notification, and Securities Count Program

Generally, the proposed recordkeeping, reporting, notification, and securities count requirements are intended to update the recordkeeping, reporting, notification, and securities count requirements for broker-dealers, including broker-dealer SBSs and broker-dealer MSBSs, to account for their security-based swap activities. The proposal is also intended to establish recordkeeping, reporting, and notification requirements for SBSs and MSBSs that are not registered as broker-dealers as well as a securities count requirement for stand-alone SBSs. The recordkeeping, reporting, notification, and securities count rules being proposed are based upon the comprehensive system of recordkeeping, reporting, notification, and securities count rules applicable to broker-dealers, as proposed to be modified to capture and document the security-based swap activities of broker-dealers, SBSs, and MSBSs. The recordkeeping, reporting, notification, and securities count rules and rule amendments being proposed today

¹²⁸³ See 17 CFR 240.17a-11(e)(1) and (2). See also *Broker-Dealer Reports*, 78 FR at 51939 (discussing amendment of material weakness standard in Rule 17a-5). As discussed above in section II.B.3.a. of this release, the Commission is proposing to use the concept of material weakness in proposed Rule 18a-7.

¹²⁸⁴ See 17 CFR 240.15c3-3(i).

represent the manner in which SBSDs and MSBSPs will document, report, and retain evidence of their compliance with, among other things, the previously proposed capital, margin, and segregation rules. The Commission believes that these rules, by their nature, will have a more limited economic impact as compared to the Commission's capital, margin, and segregation proposals.¹²⁸⁵

In proposing these requirements, the Commission is considering both the potential benefits of improving the oversight, transparency, risk documentation and management of security-based swap activities, and the potential costs to firms, the financial markets, and the U.S. financial system if broker-dealers, SBSDs, and MSBSPs are required to comply with the proposed rules.

The Commission notes that there are certain instances when it is difficult to quantify the potential benefits and costs of the proposed rules. For example, firms that choose to register in some capacity as an SBSD or MSBSP may not currently be subject to Commission, CFTC, or prudential regulation. For these firms, the Commission is not certain of such firms' current recordkeeping, reporting, notification, and securities count practices with respect to their security-based swap activities and thus it is difficult to reliably gauge the economic effect of the proposed rules and rules amendments on these firms. With regard to other classes of regulated entities, the Commission staff's experience with broker-dealers under the existing recordkeeping, reporting, notification, and securities count rules gives it a better understanding of the compliance-related costs (such as those related to retaining attorneys, accountants, and other

¹²⁸⁵

See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

professionals) and in such cases the Commission has prepared below a summary of its preliminary estimate of those costs.¹²⁸⁶

As discussed in section II. of the release, the current broker-dealer recordkeeping, reporting, notification, and securities count requirements serve as the template for the proposals for several reasons. The financial markets in which SBSDs and MSBSPs are expected to operate are similar to the financial markets in which broker-dealers operate in that they are driven in significant part by dealers that buy and sell on a regular basis and that take principal risk. The Commission believes it should take a similar regulatory approach for similar markets.

The Commission also believes that in order to prevent regulatory arbitrage, and to help ensure appropriate accountability and oversight, security-based swap activity should be regulated in a similar manner irrespective of whether it is conducted by, for example, a broker-dealer or stand-alone SBSD. The proposals applicable to stand-alone SBSDs and stand-alone MSBSPs seek to regulate these firms' security-based swap activity consistent with the regulation of security-based swap activities conducted at broker-dealers, while reflecting the business model of such entities.¹²⁸⁷ The Commission is seeking to provide all security-based swap activity, irrespective of the entity within which such activity is conducted, a level regulatory playing field while being cognizant of the fact that firms with a more limited business should also be subject to an appropriately circumscribed set of regulations.

Moreover, the rules ultimately adopted, in conjunction with other requirements established under the Dodd-Frank Act, could have a substantial impact on international

¹²⁸⁶ See *infra* section V.E.

¹²⁸⁷ In this regard, the Commission notes the proposal excludes a number of recordkeeping requirements for bank SBSDs and bank MSBSPs. As discussed above in section I. of this release, section 15F(f)(1)(B) of the Exchange Act requires such institutions to keep only those books and records of all activities related to the conduct of business as an SBSD or MSBSP.

commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions. In particular, intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the Commission's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. This could, among other potential impacts, affect the propensity of intermediaries and other market participants based in the U.S. to participate in non-U.S. markets and the propensity of non-U.S.-based intermediaries and other market participants to participate in U.S. markets. Accordingly, substantial differences between the U.S. and foreign jurisdictions in the costs of complying with the requirements established under the Dodd-Frank Act, including the reporting, recordkeeping, notification, and security count requirements for security-based swaps between U.S. and foreign jurisdictions, could have international implications.¹²⁸⁸

The Commission also preliminarily believes that there are cost and compliance benefits to be realized by utilizing an existing, well-known set of rules as a starting point. The Commission notes that the broker-dealer recordkeeping, notification, securities count, and reporting requirements have existed for many years and have facilitated the accountability and oversight of broker-dealers. From the perspective of trying to minimize regulatory costs and compliance concerns, the Commission would expect that broker-dealer SBSDs and broker-dealer MSBSPs would already be familiar with the structure and content of the recordkeeping and reporting requirements. The Commission believes that these compliance and cost benefits could be realized even by firms that are not currently registered as broker-dealers given that some of

¹²⁸⁸

See Cross-Border Security-Based Swap Activities: Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to Registration of Security-Based Dealers and Major Security-Based Swap Participants, 78 FR at 31034.

the new registrants would likely be part of larger financial firms that have a broker-dealer affiliate, thus providing a source of in-house experience with the Commission's broker-dealer rules. Even for those firms that have no source of such in-house expertise, the Commission expects that starting with the existing broker-dealer rules should require less expenditure than if the Commission created entirely new rules given that outside expertise with the current broker-dealer rules is readily available. Notwithstanding this belief, the Commission acknowledges that its proposals would likely still require new expenditures for these firms. In order to aid its analysis, the Commission requests comment on the use of the existing broker-dealer rules as a model. The Commission also requests comment on whether there are other existing rule sets that would be more appropriate.

In determining appropriate recordkeeping, reporting, notification, and securities count requirements, the Commission assesses and considers a number of different costs and benefits, and the determinations it ultimately makes can have a variety of economic consequences for the relevant firms, markets, and the financial system as a whole. The recordkeeping, reporting, notification, and securities count requirements in particular are broadly intended to facilitate effective oversight and improve internal risk management via requiring robust internal procedures for creating and retaining records central to the conduct of business as an SBSB or MSBSP. Requiring registered firms to comply with recordkeeping and reporting rules should help ensure more effective regulatory oversight. The proposed rules would help the Commission determine whether an SBSB or MSBSP is operating in compliance with the Exchange Act and the rules thereunder.

The Commission also believes that the proposed rules could promote technology improvements. Those SBSBs and MSBSPs that do not have the technology to store and

maintain the information required by the proposed rules will need to invest in technology. The technology improvements could help SBSs and MSBSs, particularly those that conducted the security-based swap business outside of any regulated entity, more effectively track their trading and risk exposure in security-based swaps. To the extent that these firms can better track their risk, this should help them better manage risk.

The Commission also believes that the required annual audit of nonbank SBSs' and nonbank MSBSs' financial statements and the public availability of firms' Statement of Financial Condition would permit customers and counterparties to have access to financial information that would permit them to better assess the financial condition of the firm. While it is difficult to quantify the current level of market confidence in the security-based swap marketplace, the Commission staff's experience is that market participants' willingness to engage in activities increases when such participants are better able to understand the financial condition of other market participants and counterparties.

The Commission also recognizes that there will be costs associated with the proposal. Those costs include the costs of complying with the proposed rules, one-time and ongoing financial reporting costs, and costs associated with ongoing record maintenance.

2. Alternatives to the Proposed Recordkeeping, Reporting, Notification, and Securities Count Rules

The Commission recognizes that there may be other appropriate approaches to establishing recordkeeping, reporting, and notification requirements. In the course of preparing and considering the rules it is proposing today, Commission staff reviewed and analyzed analogous rule sets utilized by the Commission's fellow federal regulators, with a view towards determining whether there may be other practicable alternatives. In a number of instances,

Commission staff also consulted with staff from its fellow regulators regarding the proposals herein.

The Commission believes the proposals herein are broadly consistent with the approach taken by the CFTC. The CFTC's proposed and ultimately final rules were modeled on an existing set of the rules.¹²⁸⁹ For existing broker-dealers and firms affiliated with existing broker-dealers, the Commission believes that starting with an existing and known set of rules offers practical benefits for both the regulator and the regulated entities, as compared with starting with a wholly new set of rules. The Commission acknowledges that the benefits of this approach would be much more limited for firms such as stand-alone entities that are not currently broker-dealers and are not affiliated with broker-dealers.

Although it is not possible to precisely compare rule sets across agencies, the Commission believes that the recordkeeping rules it is proposing are similar to those of the CFTC in terms of their level of prescriptiveness. For example, paragraph (a)(1) of Rule 17a-3 sets forth the requirement that a broker-dealer make and keep current a trade blotter. The Commission is also proposing very similar provisions in paragraphs (a)(1) and (b)(1) of proposed Rule 18a-5, designed to apply, respectively, to stand-alone SBSDs and stand-alone MSBSPs, as well as bank SBSDs and bank MSBSPs. Paragraph (a)(2) of the corresponding CFTC rule, Rule 202 ("Daily Trading Records"), prescribes that swap dealers and major swap participants shall make and keep trade execution records that are very similar.¹²⁹⁰

¹²⁸⁹ See Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR at 20171 (stating swap dealer and major swap participant rules are modeled on existing rules as well as those of the Commission).

¹²⁹⁰ See 17 CFR 23.202(a)(2).

In considering whether there were other practicable regulatory alternatives, the Commission also examined rules of the prudential regulators. For example, the OCC has rules governing recordkeeping and confirmation requirements for securities transactions effected by national banks.¹²⁹¹ Paragraph (a)(1) of the OCC rule governing the record that a national bank effecting securities transactions for customers must maintain, Rule 12.3, appears broadly consistent with paragraph (a)(6) of Rule 17a-3, as proposed to be amended, as well as with paragraph (b)(7) of proposed Rule 18a-5.¹²⁹²

The Commission considered regulatory approaches outside of those utilized by other regulators. One alternative would be for all SBSDs and MSBSPs to keep and report the same records and other financial reports. While technically possible and arguably simpler to implement and administer, the Commission does not believe such a requirement would be justified given the different capital, margin, and segregation proposals that would apply to each participant. For example, since a stand-alone MSBSP would not be subject to a minimum net capital requirement under the proposed capital rules that would be applicable to SBSDs and MSBSPs (it would be subject to a positive tangible net worth standard instead),¹²⁹³ it may be unduly burdensome to require stand-alone MSBSPs to calculate and report in Form SBS the amount of net capital it holds. Hence, while the Commission considered such a simpler approach, the Commission preliminarily believes that such an approach would be confusing and unduly burdensome for firms required to complete and file Form SBS and would introduce

¹²⁹¹ See 12 CFR 12.3.

¹²⁹² Compare 12 CFR 12.3(a), with paragraph (a)(6) of Rule 17a-3, as proposed to be amended, and paragraph (b)(7) of proposed Rule 18a-5.

¹²⁹³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

significant compliance challenges beyond those imposed by the proposed rules and rule amendments.

Another alternative to the rules the Commission is proposing would be rules that are less prescriptive. Under such rules, detailed record production and retention requirements could be replaced by more general references to the types of information the firm needs to document and retain for examination purposes. This approach could promote a consistent view and management of recordkeeping and reporting obligations within a large financial firm that has numerous subsidiaries. This approach would also have the advantage of likely being less costly, as the firm would be more able to conform its existing recordkeeping practices at the parent and the subsidiaries. While this approach has its benefits, the financial markets and transactions in which SBSDs and MSBSPs are expected to operate and engage in, respectively, are similar to the financial markets and transactions in which broker-dealers operate, and the Commission preliminarily believes these similarities argue for a consistent regulatory approach.¹²⁹⁴ In addition, as discussed above, the objectives of these broker-dealer requirements are similar to the objectives underlying the proposals regarding securities-based swaps.¹²⁹⁵ Notwithstanding its preliminary analysis of the issue, the Commission requests comment on whether there are existing alternative rule sets that could provide such a model, and the appropriateness of those alternatives relative to what the Commission has proposed.

The Commission has also considered alternatives to the financial reporting rules being proposed. For example, with respect to bank SBSDs and bank MSBSPs, one alternative would

¹²⁹⁴ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70216 (stating a similar rationale for basing the proposed capital, margin, and segregation requirements for SBSDs on the broker-dealer capital, margin, and segregation requirements).

¹²⁹⁵ See supra section I.

be to permit these firms to use the existing financial reports made with their respective prudential regulators. This approach would allow the firms to avoid creating and filing an additional financial report with the Commission, and would likely result in fewer compliance-related costs.

The Commission is aware of the burdens and costs associated with preparing an additional regulatory submission such as Form SBS, but the proposal is designed to ameliorate those burdens. Thus, while proposed Form SBS seeks specific transaction and position data regarding bank SBSDs' and bank MSBSPs' security-based swap activities, the other required financial data in Form SBS for bank SBSDs and bank MSBSPs come directly from the filings these firms currently make with their respective prudential regulators.¹²⁹⁶ The Commission invites comment on whether there are other ways of obtaining information regarding bank SBSDs' and bank MSBSPs' security-based swaps transactions and positions that would be less costly or burdensome and that would also facilitate Commission oversight of the transactions, positions, and financial condition of these firms.

The Commission has also considered alternative financial reporting arrangements for stand-alone SBSDs or stand-alone MSBSPs. For example, the Commission is aware that the CFTC proposed that stand-alone swap dealers and stand-alone major swap participants be required to submit monthly unaudited financial statements within 17 business days of the end of the month, as well as GAAP financial statements within 90 days of the end of the fiscal year.¹²⁹⁷ The CFTC did not prescribe any additional forms such as what the Commission is proposing with Form SBS. The Commission preliminarily believes that that the information elicited by Form SBS should assist the Commission and the firms' DEAs to conduct effective examinations

¹²⁹⁶ See supra section II.B.2.b.

¹²⁹⁷ See Capital Requirements of Swap Dealers and Major Swap Participants, 76 FR at 27813 (discussion of proposed CFTC Regulation 23.106).

of broker-dealer SBSDs and broker-dealer MSBSPs. The broker-dealer SBSD and broker-dealer MSBSP reporting requirements would promote transparency of the financial and operational condition of the broker-dealer SBSD or broker-dealer MSBSP to the Commission and to the public. In order to aid its analysis of whether there are other more appropriate alternatives relative to what it has proposed, the Commission requests comment.

The Commission has also considered alternatives to the notification and securities count proposals.¹²⁹⁸ An alternative to the proposed notification proposal would be to not have such a rule, or to have fewer events give rise to notification. Similarly, with respect to the quarterly securities count proposal, the Commission believes the alternative would be to specify a less frequent count or to omit a requirement for securities count.

The Commission has proposed the notification and securities count proposals because it preliminarily believes that the rules are an appropriate component of its oversight of the financial responsibility of firms engaged in a security-based swap business. The broker-dealer recordkeeping, reporting, notification, and security count requirements are part of the broker-dealer financial responsibility rules.¹²⁹⁹ The financial responsibility rules are designed to work together to establish a comprehensive regulatory program designed to promote the prudent operation of broker-dealers and the safeguarding of customer securities and funds held by broker-dealers. In this regard, the notification and securities count proposals (in conjunction with the recordkeeping and reporting proposals) are designed to promote compliance with the capital, margin, and segregation requirements for broker-dealers. The proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs along with the proposed capital, margin, and segregation requirements for these registrants, are

¹²⁹⁸ See *supra* section II.D.1. (summarizing rationale underlying Rule 17a-13).

¹²⁹⁹ See 17 CFR 240.3a40-1.

designed to establish a comprehensive financial responsibility program for SBSDs and MSBSPs. Like the broker-dealer rules, the proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs are designed to promote compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. Omitting such proposals would create regulatory disparities between broker-dealers, banks, and stand-alone SBSDs and stand-alone MSBSPs. For these reasons, the Commission preliminarily believes that alternative approaches would not be as effective in helping to ensure compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. However, in order to assist its analysis of the proposed notification and securities count proposals, as well whether there are more appropriate alternatives, the Commission requests comment.

3. Requirements to Make and Keep Records

a. Rule 17a-3, as Proposed to be Amended

Rule 17a-3 is proposed to be amended to account for security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs.¹³⁰⁰ The Commission is also proposing to add new provisions to Rule 17a-3 that would relate to its recently proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs.¹³⁰¹

In addition, as discussed above, the Commission has proposed amendments to Rule 15c3-1 that would establish liquidity stress test requirements for ANC broker-dealers.¹³⁰² The

¹³⁰⁰ See, e.g., paragraph (a)(1) of Rule 17a-3, as proposed to be amended (proposed addition of information that must be included in security-based swap purchase and sale blotters).

¹³⁰¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70257-70274 (proposed margin requirements applicable to SBSDs).

¹³⁰² See paragraph (f) of Rule 15c3-1, as proposed to be amended. See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252-70254.

Commission is proposing to amend Rule 17a-3 to include a requirement that ANC broker-dealers make and keep current a report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under the proposed amendments to Rule 15c3-1.¹³⁰³

The Commission would also add new provisions to Rule 17a-3 that are designed to create a record of the broker-dealer's compliance with business conduct standards that the Commission proposed pursuant to Exchange Act section 15F(h), and with the designated compliance officer requirement in Exchange Act section 15F(k) and Rule 15Fk-1.¹³⁰⁴

The Commission is also proposing some changes that are designed to eliminate obsolete or rarely used provisions of Rule 17a-3.¹³⁰⁵ For example, the Commission is proposing to remove references in the rule to "members," as a distinct class of registrant in addition to brokers and dealers.¹³⁰⁶ These references are redundant because the rule applies to brokers and dealers, which would include "members" of a national securities exchange since all such members are also broker-dealers.

Generally, the Commission would not expect the proposed changes to Rule 17a-3 to have a material economic effect, although as analyzed below the Commission does expect that there will be costs related to complying with the proposed rules.¹³⁰⁷ In order to assist its analysis the Commission generally requests comment about the general costs and benefits of the proposed

¹³⁰³ See paragraph (a)(24) of Rule 17a-3, as proposed to be amended.

¹³⁰⁴ See, e.g., paragraphs (a)(28) through (a)(30) of Rule 17a-3, as proposed to be amended. See also Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR 42396.

¹³⁰⁵ See supra section II.A.2.b. (describing additional proposed amendments to Rule 17a-3).

¹³⁰⁶ See, e.g., paragraph (a)(3) of Rule 17a-3, as proposed to be amended.

¹³⁰⁷ See infra section V.E.

rules. The Commission requests data to assess the costs and benefits of the proposals described above.

b. Proposed Rule 18a-5

The Commission is proposing new Rule 18a-5 – which is modeled on Rule 17a-3, as proposed to be amended – to require stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs to make and keep current certain records.¹³⁰⁸ Not all of the provisions of Rule 17a-3 would be imported into proposed Rule 18a-5 because some of Rule 17a-3's provisions relate to activities that are not expected or permitted of stand-alone SBSDs and stand-alone MSBSPs. Further, and as described above,¹³⁰⁹ the proposed requirements for bank SBSDs and bank MSBSPs, which would be included in paragraph (b) of proposed Rule 18a-5, are more limited than the proposed requirements that would apply to stand-alone SBSDs and stand-alone MSBSPs, which would be included in paragraph (a) of proposed Rule 18a-5. More limited requirements would apply to bank SBSDs and bank MSBSPs because the Commission's authority under section 15F(f)(1)(B)(i) of the Exchange Act is tied to activities related to their business as an SBSD or MSBSP,¹³¹⁰ banks are already subject to the existing recordkeeping requirements from prudential regulators, and the prudential regulators are responsible for capital, margin, and other prudential requirements applicable to bank SBSDs and bank MSBSPs.

The Commission believes proposed Rule 18a-5 would provide improved regulatory oversight of the security-based swap activities of stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs. For reasons discussed above, the Commission preliminarily believes that the approach it has taken with respect to Rule 18a-5 – basing it upon an existing

¹³⁰⁸ See *supra* section II.A.2.a. (describing proposed Rule 18a-5).

¹³⁰⁹ *Id.*

¹³¹⁰ See 15 U.S.C. 78o-10(f)(1)(B)(i).

rule (Rule 17a-3) – is a better approach than starting with a wholly new rule. The Commission believes that many non-broker-dealer SBSDs and non-broker-dealer MSBSPs will be affiliates of broker-dealers that already have familiarity with Rule 17a-3 upon which proposed Rule 18a-5 is modeled. Greater familiarity with the rule should ease compliance burdens and costs for those firms. The Commission acknowledges that with respect to firms not so affiliated, this approach would seem much less likely to ease compliance burdens. In order to aid the Commission's analysis of the effects on these unaffiliated firms, and whether there are better alternatives, the Commission requests comment.

As discussed in section V.C.1., above, the Commission believes that the proposed requirements to make and keep records could improve the regulatory oversight, risk documentation, and risk management of security-based swap activities.

The proposed requirements to make and keep records could also create costs to firms.¹³¹¹ These increased costs may cause firms to cease participating in the market, thereby potentially reducing efficiency due to loss of competition. In order to inform its analysis of the costs and benefits involved with the proposals, the Commission requests comment. Data to evaluate the costs and benefits of proposed Rule 18a-5 would be particularly useful to the Commission's analysis.

c. Request for Comment on Recordkeeping Provisions

The Commission also requests data to evaluate the impact of the proposals against the baseline. In addition, the Commission requests comment in response to the following questions:

1. In general terms, would the proposed rules result in effective documentation of the security-based swap transactions of broker-dealers, broker-dealer SBSDs, broker-dealer

¹³¹¹ See *infra* section V.E. (discussing implementation considerations).

MSBSPs, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs?

Please explain.

2. In general, would the proposed rules and rule amendments impact the capital of entities that would need to register as SBSDs or MSBSPs? For example, would the costs involved negatively impact the availability of funding to conduct the security-based swap activities? If so, what would be the extent of the impact to these entities?
3. How important is it that the recordkeeping and reporting rules for SBSDs and MSBSPs be analogous to the existing recordkeeping and reporting requirements for broker-dealers? How valuable or worthwhile are the benefits involved with this approach? How costly is such an approach?
4. To what extent would the proposed regulatory requirements impact the amount of liquidity provided for or required by security-based swap market participants, and to what extent will that affect the funding cost for the financial sector in particular and the economy in general? Please quantify.
5. Do the proposed record-making requirements provide a reasonable and workable solution for broker-dealers, SBSDs and MSBSPs? Please explain. Are there preferable alternatives? If so, describe those alternatives. Please specifically address why such alternatives are preferable and the nature to which they fulfill the Commission's need to ensure that the financial responsibility requirements applicable to broker-dealers, broker-dealer SBSDs, broker-dealer MSBSPs, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs are followed.

6. If an SBSD or MSBP currently already has sufficient technology to track its trading and risk exposure in security-based swaps, what additional costs, if any, would arise from the proposed rules?

4. Requirements to Preserve Records

As discussed above,¹³¹² Rule 17a-4 requires a broker-dealer to preserve certain types of records.¹³¹³ The rule also prescribes the time periods these records and the records required to be made and kept current under Rule 17a-3 must be preserved and the manner in which they must be preserved.¹³¹⁴ The Commission is proposing amendments to Rule 17a-4 to account for the security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, as well as certain technical amendments. With respect to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs, the Commission is proposing new Rule 18a-6 – modeled on Rule 17a-4, as proposed to be amended – to establish record preservation requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs.

a. Rule 17a-4, as Proposed to be Amended

As described above,¹³¹⁵ paragraph (a) of Rule 17a-4 provides that broker-dealers subject to Rule 17a-3 must preserve for a period of not less than six years, the first two in an easily accessible place, certain records required to be made and kept current under Rule 17a-3.

¹³¹² See supra section II.A.3.a. (discussing Rule 17a-4 retention requirements).

¹³¹³ See 17 CFR 240.17a-5(b).

¹³¹⁴ See 17 CFR 240.17a-5(a) and 240.17a-5(b)(1). Generally, the three year and six year retention periods in Rule 17a-4 track the self-regulatory organization requirements and certain State regulations that were in effect prior to the adoption of the National Securities Market Improvements Act of 1996, and they largely represent a codification of prudent recordkeeping practices of many broker-dealers. Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, 66 FR at 55819; National Securities Market Improvements Act of 1996, Pub. L. 104-290, 104 Stat. 3416 (1996).

¹³¹⁵ See supra section II.A.3.a. (discussing Rule 17a-4 retention requirements).

Three-Year Preservation Requirement for Rule 17a-3 Records

As discussed above,¹³¹⁶ paragraph (b)(1) of Rule 17a-4 provides that broker-dealers must preserve for at least three years, the first two in an easily accessible place,¹³¹⁷ certain records required to be made and kept current under Rule 17a-3.¹³¹⁸ The Commission is proposing to add cross-references to certain new paragraphs that would be added to Rule 17a-3 to address security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs.

The Commission preliminarily believes that the majority of the economic effects, ranging from firm-specific costs to effects on the overall security-based swap market, will be associated with the requirement that broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, make and keep current certain records as set forth in Rule 17a-3, as proposed to be amended. However, in order to assist it in considering the full range of costs and any economic effects associated with the proposed recordkeeping rules, the Commission requests data to assess the costs and benefits of the proposals.

Three-Year Preservation Requirement for Certain Other Records Made or Received

Paragraph (b) of Rule 17a-4 also provides that broker-dealers must preserve for a period of not less than three years, the first two in an easily accessible place, other categories of records if the broker-dealer makes or receives the record.¹³¹⁹ As discussed above,¹³²⁰ the Commission is

¹³¹⁶ See supra section II.A.3.a. (discussing Rule 17a-4 retention requirements).

¹³¹⁷ The Commission has stated that “Rule 17a-4 seeks to address the tension between the need for quick production of specific records and the volume of records generated on a daily basis, by requiring that more current records be retained in an “easily accessible place,” which the Commission has not defined. See Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), 66 FR 22916.

¹³¹⁸ See 17 CFR 240.17a-4(b)(1).

¹³¹⁹ See 17 CFR 240.17a-4(b)(2) through (12).

¹³²⁰ See supra section II.A.3.a. (discussing paragraph (b) of Rule 17a-4, as proposed to be amended).

proposing amendments to these provisions in paragraph (b) of Rule 17a-4 to account for security-based swaps, and is proposing amendments that would require broker-dealers, including broker-dealer SBSs and broker-dealer MSBSs, to preserve certain additional records related to security-based swap activities. For example, the Commission is proposing to amend the preservation requirement in paragraph (b)(4) of Rule 17a-4 to include “recordings of telephone calls required to be maintained pursuant to section 15F(g)(1) of the [Exchange] Act.” The amendment would establish a preservation period for recorded telephonic communications that have been recorded and relate to security-based swap activity.

As discussed above in section V.C.1. of this release, the Commission believes that the proposed amendments to Rule 17a-4 will result in benefits of improving the regulatory oversight, risk documentation, and risk management of security-based swap activities. The Commission anticipates that there will also be costs related to the proposal.¹³²¹ The Commission believes that the majority of the costs incurred by broker-dealer SBSs and broker-dealer MSBSs relating to recorded telephone calls would enhance the internal controls and procedures relating the treatment of security-based swap-related telephone calls recorded by the firm. The Commission requests comment on the costs or benefits that may accrue in connection with the proposal.

b. Proposed Rule 18a-6

As described above, Rule 18a-6 is modeled on the retention requirements of Rule 17a-4, but modified to account for differences applicable to stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs.¹³²²

¹³²¹ See infra section V.E. (discussing implementation considerations).

¹³²² See supra section II.A.3.a. (discussing proposed amendments to Rules 17a-4 and 18a-6).

Six-Year Preservation Requirement

The Commission proposes that many, but not all, of the same recordkeeping requirements that would be applicable to broker-dealer SBSs and broker-dealer MSBSs under the proposed amendments to Rule 17a-4 would also apply to stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs under proposed Rule 18a-6.

Paragraph (a) of Rule 18a-6 would require that certain records required to be created and maintained under Rule 18a-5 be preserved for a period of not less than six years, the first two in an easily accessible place. Further, paragraph (a)(1) of proposed Rule 18a-6 would apply to stand-alone SBSs and stand-alone MSBSs. Paragraph (a)(2) of proposed Rule 18a-6 would apply to bank SBSs and bank MSBSs.

Three-Year Preservation Requirement for Other Rule 18a-5 Records

As discussed above,¹³²³ paragraphs (a) and (b) of proposed Rule 18a-5 would require stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs to make and keep current records that are modeled on the records required to be made and kept under Rule 17a-3. Paragraph (b)(1) of proposed Rule 18a-6 would require that records required to be made by stand-alone SBSs and stand-alone MSBSs under Rule 18a-5, be retained for three years, the first two years in an easily accessible place. Paragraph (b)(2) of proposed Rule 18a-6 would establish a three-year record retention period for certain delineated records, as well as the records required to be made by bank SBSs and bank MSBSs under Rule 18a-5.

Three-Year Preservation Requirement for Certain Other Records Made or Received

The Commission is also proposing in paragraph (b) of Rule 18a-6 that stand-alone SBSs, stand-alone MSBSs, bank SBSs, and bank MSBSs must preserve for a period of not

¹³²³

See supra section II.A.2.a. (discussing paragraphs (a) and (b) of proposed Rule 18a-5).

less than three years, the first two years in an easily accessible place, other categories of records if the SBSB or MSBSP makes or receives the record.¹³²⁴

As discussed below, the Commission preliminarily believes that there will be costs stemming from the requirement that stand-alone SBSBs, stand-alone MSBSPs, bank SBSBs, and bank MSBSPs make and keep current certain records as set forth in proposed Rule 18a-5.¹³²⁵ As further discussed below, the Commission preliminarily believes that the requirement to retain these records, once made and kept current, should represent a marginal cost to registrants.¹³²⁶

In order to assist its evaluation of the costs and benefits, as well as any larger economic effects associated with the proposal, the Commission requests comment.

5. Reporting

As stated above, Rule 17a-5 has two main elements: (1) a requirement that broker-dealers file periodic unaudited reports containing information about their financial and operational condition on a FOCUS Report; and (2) a requirement that broker-dealers annually file financial statements and certain reports and a report covering the financial statements and reports prepared by an independent public accountant registered with the PCAOB in accordance with PCAOB standards.¹³²⁷

The reporting program codified in Rule 17a-5 is designed, among other things, to promote compliance with Rules 15c3-1 and 15c3-3 and to assist the Commission, SROs, and state securities regulators in conducting effective examinations of broker-dealers. Those publicly available broker-dealer reporting requirements, such as the statement of financial condition,

¹³²⁴ See supra section II.A.3.a. (discussing provision-by-provision retention provisions in Rules 17a-4 and proposed Rule 18a-6).

¹³²⁵ See infra section V.E.

¹³²⁶ Id.

¹³²⁷ Id. These requirements are described in more detail below.

would promote transparency of the financial and operational condition of the broker-dealer to the Commission, the firm's DEA, and to the public.

The Commission preliminarily believes that the economic effects associated with the new reporting requirements would depend upon the nature of the filings such registrants make today based upon their registration status (e.g., broker-dealer vs. non-broker-dealer). The Commission preliminarily believes that the majority of the economic effects associated with the Title VII rulemakings will stem from the requirements relating to capital, margin, and segregation¹³²⁸ as compared to the proposed rules in the instant rulemaking.

The Commission is cognizant, however, that the proposed reporting requirements could create costs to firms, and indirectly to the financial markets. For example, the Commission recognizes that there will be new compliance and audit costs associated with the required financial report and compliance report. While the Commission is aware of these costs, section 15F(f) of the Exchange Act provides the Commission with authority to require each registered SBSB to make a report regarding, among other things, the financial condition of the firm. The Commission believes that it would be impractical to monitor the financial condition of SBSBs without periodic financial reports, including annual audited reports, that elicit detail about these firms' security-based swap activities.

The Commission notes that it has proposed steps to minimize costs where appropriate and consistent with its statutory mandate. For example and as described in more detail below,¹³²⁹ for stand-alone SBSBs, the Commission would not require the filing of several of the

¹³²⁸ For example, the Commission anticipates substantial economic costs to arise as a result of the capital, margin, and segregation requirements that have been proposed to apply to SBSBs and MSBSPs. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70299-70328.

¹³²⁹ See supra section II.B.2.b.

reports that are required to be filed by broker-dealers, such as the Form Custody or the information filed with SIPC by broker-dealers.¹³³⁰ Further, the decision to model Form SBS on the current FOCUS Report was made in part to reduce the uncertainty and additional compliance costs that would stem from devising an entirely new reporting form and rules. While the Commission understands that stand-alone SBSDs may not currently be registered as broker-dealers and thus may not currently be filing the FOCUS Report (and thus have no familiarity with it), many stand-alone SBSDs may be affiliated with or part of a larger financial firm that contains a broker-dealer, thus providing a source of experience, internal to the firm, with the FOCUS Report which in turn may reduce the compliance-related costs. Moreover, the accounting and legal communities are familiar with the FOCUS Report, so the Commission preliminarily believes that this familiarity should mitigate the compliance costs for stand-alone SBSDs insofar as outside assistance is well-versed with the FOCUS Report. At the same time, the Commission acknowledges that there may be stand-alone SBSDs affiliated with, for example, FCMs, and those firms would conceivably benefit from rules based upon or similar to CFTC rules.

In order to aid its analysis of the economic effects relating to the proposed reporting requirements, the Commission requests comment. Comments setting forth specific costs related to the proposed reporting requirements, as well as benefits, would be particularly helpful to the Commission's analysis.

¹³³⁰

See 17 CFR 240.17a-5(a)(4) and (e)(4).

a. Broker-Dealer SBSDs and Broker-Dealer MSBSPs

Form SBS

As described above,¹³³¹ broker-dealer SBSDs and broker-dealer MSBSPs would file proposed Form SBS instead of a particular version of the FOCUS Report. An ANC broker-dealer that currently files FOCUS Part II CSE that registers with the Commission as an SBSD or MSBSP would experience the smallest marginal impact on its reporting obligations. This is the case because proposed Form SBS is modeled upon Part II CSE, but includes additional line items and sections to elicit more detail about security-based swap and swap activities.¹³³² Similarly, for dealers currently registered as OTC derivatives dealers, to the extent these firms decide to register as broker-dealer SBSDs or broker-dealer MSBSPs, the Commission preliminarily believes that the burdens involved would be similarly modest to those encountered by the ANC broker-dealers because Part IIB of the FOCUS Report contains many similar line items as Part II CSE.¹³³³

The information elicited by Form SBS from the ANC broker-dealers and OTC derivatives dealers that decide to register as broker-dealer SBSDs or broker-dealer MSBSPs should assist the Commission and the firms' DEAs to conduct effective examinations of broker-dealer SBSDs and broker-dealer MSBSPs. The broker-dealer SBSD and broker-dealer MSBSP reporting requirements would promote transparency of the financial and operational condition of the broker-dealer SBSD or broker-dealer MSBSP to the Commission and to the public.

With respect to the economic effects associated with this aspect of the proposal, the Commission preliminarily believes that the scope of additional information requested in Form

¹³³¹ See *supra* section II.B.2. (discussing broker-dealer SBSDs' and broker-dealer MSBSPs' use of proposed Form SBS).

¹³³² *Id.*

¹³³³ See *supra* section II.B.2.b.

SBS, generally related to the firms' security-based swap activities, is relatively circumscribed relative to what these registrants report in Part II CSE or Part IIB of the FOCUS Report.

With respect to broker-dealers that currently do not file FOCUS Part II CSE or FOCUS Part IIB, the Commission believes the economic impact and, more specifically, the costs associated with complying with new Form SBS, may be more substantial. This is the case because, as described above,¹³³⁴ Form SBS elicits much of the same information as FOCUS Part II CSE and FOCUS Part IIB, but includes additional line items and sections to elicit more detail about security-based swap and swap activities. Accordingly, for those firms not currently filing FOCUS Part II CSE or FOCUS Part IIB, there will be a greater change, in terms of the amount of information that will be elicited on the form. These firms may incur greater compliance-related costs.

The Commission has carefully considered Form SBS in light of its experience with broker-dealer regulation and in relation to its new statutory responsibilities under section 15F of the Exchange Act and preliminarily believes that Form SBS would promote compliance with Rules 15c3-1 and 15c3-3 and to assist the Commission, SROs, and state securities regulators in conducting effective examinations of broker-dealer SBSDs and broker-dealer MSBSPs. The proposed broker-dealer SBSD and broker-dealer MSBSP reporting requirements would promote transparency of the financial and operational condition of the broker-dealer to the Commission, the firm's DEA, and to the public.

The Commission has designed Form SBS to elicit the information that it believes it needs to effectively oversee the financial condition of broker-dealer SBSDs and broker-dealer MSBSPs. To aid its analysis of whether there are parts of Form SBS that could be curtailed or

¹³³⁴

See *supra* section II.B.2.

eliminated in order to lessen compliance-related costs, the Commission requests comment. To the extent that commenters believe that information the Commission has proposed to elicit is unnecessary, specific reasons for such a view would be particularly helpful. Moreover, if commenters object to certain sections of Form SBS, specific estimates of the costs to comply with those sections would also aid the Commission's analysis of regulatory necessity. Finally, in order to help it consider and evaluate the full range of effects associated with the proposal, the Commission requests data to assess the costs and benefits of the proposals with respect to the various classes of registrants (e.g., Part IIA filers, Part II filers, Part IIB filers, and Part II CSE filers).

Audited Annual Reports

As discussed below, the Commission anticipates that there may be costs associated with broker-dealer SBSs or broker-dealer MSBSPs completing and filing the annual reports required under paragraph (d) of Rule 17a-5.¹³³⁵ Currently, as described in more detail above, broker-dealers are required to file on an annual basis a financial report that includes many parts of the FOCUS Report in a format consistent with the version of FOCUS Report filed by the broker-dealer.¹³³⁶ The proposed amendments to the financial report would include additional information about the broker-dealer's security-based swap activity not included in the financial report currently filed by broker-dealer.¹³³⁷ Moreover, the proposal would increase the cost of completing the annual compliance report filed by a broker-dealer SBS because the compliance

¹³³⁵ See infra section V.E. (relating to implementation considerations).

¹³³⁶ See 17 CFR 240.17a-5(d)(2).

¹³³⁷ Compare, e.g., FOCUS Report Part II CSE, Statement of Financial Condition, Line 4, with Form SBS, Statement of Financial Condition, Line 4.

report for such firms would include statements about the firm's compliance with proposed Rule 18a-4, the proposed customer segregation rule that would apply to broker-dealer SBSBs.¹³³⁸

The Commission also anticipates that the cost to audit the annual reports filed by broker-dealer SBSBs or broker-dealer MSBSPs would rise.¹³³⁹ Currently, and as described in more detail above, broker-dealers are required to engage a PCAOB-registered independent public accountant to conduct an annual audit of the broker-dealer's annual reports.¹³⁴⁰ The Commission believes the additional required components to the financial report and the compliance report would increase the costs of ongoing compliance as well as the annual audit.

Liquidity Stress Test

As discussed above,¹³⁴¹ the Commission has proposed amendments to Rule 15c3-1 that would establish liquidity stress test requirements for ANC broker-dealers, which would include ANC broker-dealer SBSBs.¹³⁴² Under the proposed liquidity stress test requirements, ANC broker-dealers would be required, among other things, to: (1) perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days; and (2) maintain at all times liquidity reserves based on the results of the liquidity stress test comprised of unencumbered cash or U.S. government securities.¹³⁴³ The proposed liquidity stress test requirement is designed to provide an additional level of protection against disruptions

¹³³⁸ See supra section II.B.3.a.; see infra section V.E.

¹³³⁹ Id.

¹³⁴⁰ See supra section II.B.1.

¹³⁴¹ See supra section II.A.2.a.

¹³⁴² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70252-70254. See also paragraph (f) of Rule 15c3-1, as proposed to be amended.

¹³⁴³ Id.

in the firm's ability to obtain funding for a firm with significant proprietary positions in securities or derivatives.¹³⁴⁴

The Commission is proposing that ANC broker-dealers report to the Commission the results of the liquidity stress test on a monthly basis.¹³⁴⁵ The Commission has discussed the economic effects associated with the liquidity stress test requirement and requested comment on those effects.¹³⁴⁶ As discussed below, the Commission preliminarily believes that paragraph (a)(5)(vii) of Rule 17a-5 would create a cost to file the report, but that such costs would not materially contribute to the economic effects associated with the liquidity stress test proposal.¹³⁴⁷

As discussed above in section V.C.1. of this release, above, the Commission believes that the proposed reporting requirements will result in benefits of improving the oversight, transparency, and accountability of security-based swap activities.

In order to help it consider and evaluate the full range of effects associated with the proposal, the Commission requests comment on the anticipated benefits and costs of this portion of the proposed rule changes. Quantitative and qualitative data would be particularly useful to the Commission in helping it evaluate the proposals.

b. Stand-Alone SBSDs

Form SBS

As described in more detail above,¹³⁴⁸ stand-alone SBSDs would be required to file Form SBS with the Commission or its designee on a monthly basis.¹³⁴⁹ Given that stand-alone SBSDs

¹³⁴⁴ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70314.

¹³⁴⁵ See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

¹³⁴⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70314.

¹³⁴⁷ See infra section V.E.

¹³⁴⁸ See supra section II.B.2.

are not broker-dealers, these firms would not have experience filing the FOCUS Report, and thus reporting on Form SBS could represent a significant undertaking. While the Commission expects that stand-alone SBSDs currently prepare financial statements that encompass their security-based swap activity, the reporting on Form SBS may require that firms establish new systems that facilitate the reporting of the required information.¹³⁵⁰ Relative to what these firms generate now, Form SBS would likely elicit greater detail about the registrant's security-based swap positions, which in turn would require the registrants to have additional details about the firm's security-based swap positions in order to be able to provide the security-based swap information elicited by Form SBS. Since many of the entities that the Commission expects will register as stand-alone SBSDs are currently not regulated, they are likely to be unaccustomed to completing and filing detailed reports with financial regulators. Therefore, and as discussed below, the Commission anticipates that stand-alone SBSDs will bear substantial costs in connection with completing and filing Form SBS.¹³⁵¹

Audited Annual Reports

In addition, stand-alone SBSDs would be required to generate and file its financial report and compliance report with the Commission on an annual basis.¹³⁵² While the Commission expects that stand-alone SBSDs currently prepare financial statements that encompass their security-based swap activity, under the proposed rules, stand-alone SBSDs would be required to prepare a financial report in a format consistent with Form SBS, which includes numerous

¹³⁴⁹ The Commission estimates that nine of the approximately fifty entities that it anticipates to register with the Commission as SBSDs will be stand-alone SBSDs.

¹³⁵⁰ For example, stand-alone SBSDs would be required to submit computations relating to the firm's level of net capital, net capital required, and amount required to be held in the special reserve account for the exclusive benefit of security-based swap customers. See supra section II.B.2.

¹³⁵¹ See infra section V.E.

¹³⁵² See paragraph (c) of proposed Rule 18a-7.

entries, computations, and schedules that a stand-alone SBSB may not prepare on its own accord. The compliance report would contain several statements and descriptions related to the firm's compliance with the financial responsibility rules that would be entirely new for most stand-alone SBSB registrants. Stand-alone SBSBs would be required to hire a PCAOB-registered independent public accountant to prepare an audit report covering annual reports. As explained below, the Commission estimates that all stand-alone SBSBs would incur compliance-related costs engaging a PCAOB-registered accountant to perform the audit.¹³⁵³

Stand-Alone ANC SBSB Reporting Requirements

For stand-alone ANC SBSBs, there would be a number of additional monthly and quarterly reporting requirements, independent of those on Form SBS.¹³⁵⁴ The additional stand-alone ANC SBSB reports are modeled on parallel reporting requirements for ANC broker-dealers.¹³⁵⁵ Consequently, stand-alone ANC SBSBs would be required to file the same types of additional reports relating to their use of internal models and liquidity stress tests as ANC broker-dealers, including ANC broker-dealer SBSBs.

As discussed below, the Commission preliminarily believes that stand-alone ANC SBSBs may incur compliance costs related to, among other things, preparing and filing the additional reports that would be required under the proposed rules.¹³⁵⁶ The Commission believes the additional reports that stand-alone ANC SBSBs would be required to file with the Commission would give rise to less substantial compliance costs relative to the other costs under the proposal because the additional reporting obligations for such firms are relatively few and are

¹³⁵³ See infra section V.E.

¹³⁵⁴ See supra section II.B.3.a. See also paragraph (a)(3) of proposed Rule 18a-7.

¹³⁵⁵ Compare paragraph (a)(3) of proposed Rule 18a-7, with paragraph (a)(5) of Rule 17a-5, as proposed to be amended.

¹³⁵⁶ See infra section V.E. See also paragraph (a)(3) of proposed Rule 18a-7.

generally closely related to their use of internal models approved by the Commission to calculate market and credit risk. Stand-alone ANC SBSDs would incur the majority of costs associated with these internal models in designing and operating the models themselves rather than the reports arising from these models.

The Commission also preliminarily believes that utilizing the new reporting requirements would have the benefit of helping the Commission evaluate whether a stand-alone SBSD is operating in compliance with the Exchange Act and the rules thereunder. For stand-alone SBSDs that previously did not produce detailed financial statements, the proposal could require these firms to upgrade their technology to store and maintain the information they need to report on Form SBS. These upgrades would likely entail costs for the firms, discussed below, but also possibly help these firms more efficiently track their trading and risk exposure in security-based swaps.¹³⁵⁷ The Commission also preliminarily believes that the availability of Form SBS will greatly enhance the Commission's ability to oversee the financial condition of these registrants, and the public availability of a firm's audited Statement of Financial Condition and net capital computations will facilitate the public's evaluation of the financial health of a registrant.

In order to assist its evaluation of any potential economic effects associated with the proposals, the Commission requests data to help it evaluate the costs and benefits commenters believe would result.

c. Stand-Alone MSBSPs

The Commission preliminarily believes the economic impact associated with the proposed reporting requirements on stand-alone MSBSPs would be significantly less than the effects upon stand-alone SBSDs. As with stand-alone SBSDs, the reporting requirement would

¹³⁵⁷ See infra section V.E.

be an entirely new obligation for stand-alone MSBSPs. However, there would be a number of important differences between the reporting requirements of stand-alone MSBSPs as compared to stand-alone SBSDs.

Form SBS

First, stand-alone MSBSPs would be required to complete a simpler Computation of Tangible Net Worth, compared to the much longer and complex Computation of Net Capital and Computation of Minimum Regulatory Capital Requirements sections in Part 1 of the form that stand-alone SBSDs are required to complete.¹³⁵⁸ The Commission believes that stand-alone SBSDs and stand-alone MSBSPs will incur costs completing those parts of Form SBS that are applicable to such entities, as discussed below.¹³⁵⁹ Moreover, stand-alone SBSDs would not be required to complete the sections in Part 1 of Form SBS that require firms to compute the amount that must be maintained in the security-based swap customer reserve account or the section relating to information for the possession or control requirements for security-based swap customers because stand-alone MSBSPs generally will not be subject to those requirements under proposed Rule 18a-4.¹³⁶⁰ Furthermore, stand-alone MSBSPs would not be required to complete and file a number of sections of Part 1 of the form that relate to the operational data related to the firm; specifically, they would not be required to complete and file the Capital Withdrawals, Capital Withdrawals Recap, and the Financial and Operational Data sections of Form SBS.¹³⁶¹

¹³⁵⁸ Compare Form SBS, Computation of Tangible Net Worth, with Form SBS, Computation of Net Capital (Filer Authorized to Use Models) and Form SBS, Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer).

¹³⁵⁹ See infra section V.E.

¹³⁶⁰ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70274–70288.

¹³⁶¹ See Form SBS, Capital Withdrawals, Capital Withdrawals Recap, and Financial and Operational Data.

Audited Annual Reports

Stand-alone MSBSPs would be required to comply with the proposed requirements relating to the preparation, auditing, and filing of the annual reports.¹³⁶² As discussed below, the Commission estimates that all stand-alone MSBSPs would incur costs stemming from the requirement to engage a PCAOB-registered auditor.¹³⁶³ The Commission anticipates that stand-alone MSBSPs will incur fewer costs in complying with these requirements as compared to stand-alone SBSs because stand-alone MSBSPs would not be required to file the compliance report or the exemption report.

As discussed above in section V.C.1. of this release, the Commission believes that the proposed reporting requirements for stand-alone MSBSPs will result in benefits by improving the regulatory oversight of security-based swap activities. The Commission also recognizes that the proposed reporting requirements would create costs. Preliminarily, the Commission believes most of these costs would be compliance-related, as discussed in more detail below.¹³⁶⁴ In order to help it consider and evaluate the full range of costs and larger economic effects, if any, associated with the proposed requirement for stand-alone MSBSPs to complete and submit Form SBS, and to submit annual audited financial statements, the Commission requests comment. Data to assess the costs and benefits of the reporting requirements that would apply to stand-alone MSBSPs would be particularly useful.

¹³⁶² See supra section II.B.3.a.

¹³⁶³ See infra section V.E.

¹³⁶⁴ See infra section V.E.

d. Bank SBSDs and Bank MSBSPs

As described above,¹³⁶⁵ bank SBSDs and bank MSBSPs would also have to periodically complete and file Form SBS with the Commission. However, relative to broker-dealer SBSDs, broker-dealer MSBSPs, stand-alone SBSDs, and stand-alone MSBSPs, banks would report less information on Form SBS. The financial information bank SBSDs and bank MSBSPs would provide in Part 2 of the Form is based on the "call report" banks file with the prudential regulators.¹³⁶⁶ Bank SBSDs and bank MSBSPs would also report, in Part 5 of Form SBS, information relating to their security-based swap activities, consistent with the directive in section 15F(f) of the Exchange Act. Bank SBSDs and bank MSBSPs would also be required to report on change of fiscal year, as well as if the registrant changes accountants. However, bank SBSDs and bank MSBSPs would not be required to complete and file the audited financial report. The Commission has limited the number of schedules that would be required to be completed and filed by bank SBSDs and bank MSBSPs within Part 5 of Form SBS to one schedule that elicits detailed information about the firm's security-based swap positions. This requirement in Part 5 would require the bank SBSD or bank MSBSP to create and maintain additional details about the firm's security-based swap positions in order to be able to disclose the necessary detail on Form SBS.

As discussed in more detail below, the Commission preliminarily believes that bank SBSDs and bank MSBSPs will incur compliance costs related to reporting the information that would be required on Form SBS.¹³⁶⁷ However, the Commission has limited the number of schedules to be reported in Part 5 to one schedule that is generally derived from the bank

¹³⁶⁵ See supra section II.B.2.

¹³⁶⁶ See 12 U.S.C. 324; 12 U.S.C. 1817; 12 U.S.C. 161; 12 U.S.C. 1464.

¹³⁶⁷ See infra section V.E.

SBSD's or bank MSBSP's call report. Thus, the Commission does not believe Part 2 would require substantial additional effort to complete.¹³⁶⁸

The Commission preliminarily believes the reporting requirements for bank SBSs and bank MSBSPs would help ensure that registrants follow applicable capital, margin, and segregation rules. The Commission believes that such capital, margin, and segregation rules are an integral part to ensuring that security-based swap activity is conducted in a financially responsible manner.

The Commission requests comment about its analysis of the costs and benefits of the proposal with respect to bank SBSs and bank MSBSPs. The Commission requests data to assess the costs and benefits of the proposals for bank SBSs and bank MSBSPs.

6. Notification Requirements

As discussed above,¹³⁶⁹ the Commission is proposing certain notification requirements for SBSs and MSBSPs that are, in general, modeled on existing notification provisions that apply to broker-dealers pursuant to Rule 17a-11. As discussed below, the Commission has utilized its experience with broker-dealers utilizing Rule 17a-11 to prepare cost estimates of certain compliance-related expenses.¹³⁷⁰ As with the other proposals being considered, the Commission believes that the vast majority of the economic effects associated with registering as an SBSD or MSBSP would stem from the capital, margin, and segregation rules that the Commission proposed pursuant to Title VII of the Dodd-Frank Act.¹³⁷¹

¹³⁶⁸ Whenever possible, the Commission has proposed the same line item numbers as are used for the call report (but appended with the letter "b" in Form SBS) to facilitate a bank SBSD's or bank MSBSP's use of data from the call report.

¹³⁶⁹ See *supra* section II.C.1.

¹³⁷⁰ See *infra* section V.E.

¹³⁷¹ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70276.

a. Broker-Dealer SBSs and Broker-Dealer MSBs

A broker-dealer SBS would be required to notify the Commission when it fails to make a deposit in its security-based swap customer account, as required by proposed Rule 18a-4.¹³⁷² An ANC broker-dealer would be required to give immediate notice to the Commission if a liquidity stress test it performs indicates an insufficient amount of liquidity reserve.¹³⁷³ Finally, broker-dealer MSBs would be required to notify the Commission when their level of tangible net worth fell below \$20 million.¹³⁷⁴

Outside of certain compliance-related costs, discussed below, the Commission does not believe that the notification requirements would have an economic impact.¹³⁷⁵ In each case, the notification requirement would be incidental to a related underlying substantive obligation that would be the primary source of economic impact.

As discussed above in section V.C.1. of this release, the Commission believes that the proposed amendments to Rule 17a-11 would result in improving the Commission and DEA oversight of broker-dealer SBSs and broker-dealer MSBs' security-based swap activities, including activities and financial conditions that suggest a material level of risk to the firm.

The Commission requests comment about its analysis of the costs and benefits of the proposal with respect to broker-dealer SBSs and broker-dealer MSBs. The Commission requests data to assess the costs and benefits of the proposals for broker-dealer SBSs and broker-dealer MSBs.

¹³⁷² See paragraph (f) of Rule 17a-11, as proposed to be amended.

¹³⁷³ See paragraph (e) of Rule 17a-11, as proposed to be amended.

¹³⁷⁴ See paragraph (b)(6) of Rule 17a-11, as proposed to be amended.

¹³⁷⁵ See *infra* section V.E.

b. Stand-Alone SBSDs, Stand-Alone MSBSPs, Bank SBSDs, and Bank MSBSPs

The Commission is proposing to establish notification requirements in Rule 18a-8 for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs that are modeled closely upon the requirements applicable to broker-dealers. First, the Commission is proposing to include a net capital deficiency and tentative net capital deficiency notification requirement in paragraph (a)(1) of proposed Rule 18a-8 applicable to stand-alone SBSDs that is modeled on the notification requirements applicable to broker-dealers, over-the-counter derivatives dealers, and ANC broker-dealers that appear in paragraph (a) of Rule 17a-11, as proposed to be amended.¹³⁷⁶ Furthermore, a stand-alone MSBSP would be required to notify the Commission when it fails to maintain a positive tangible net worth.¹³⁷⁷ The Commission is also proposing to include “early warning” notification requirements in paragraph (b) of proposed Rule 18a-8 that would be applicable to stand-alone SBSDs and stand-alone MSBSPs that are modeled after the relevant early warning provisions applicable to broker-dealers in paragraph (b) of Rule 17a-11, as proposed to be amended.¹³⁷⁸ The Commission also is proposing a requirement for a stand-alone SBSD to notify the Commission in the event of the discovery of a material weakness, as is required for broker-dealers under paragraph (d) of Rule 17a-11, as proposed to be amended.¹³⁷⁹ Moreover, the proposed requirement for a stand-alone SBSD to notify the Commission if it fails to make a required deposit in its security-based swap customer reserve account is modeled on a

¹³⁷⁶ Compare paragraph (a)(1) of proposed Rule 18a-8, with paragraph (a) of Rule 17a-11, as proposed to be amended.

¹³⁷⁷ See paragraph (a)(2) of proposed Rule 18a-8.

¹³⁷⁸ Compare paragraph (b) of proposed Rule 18a-8, with paragraphs (b)(3), (b)(4), and (b)(6) of Rule 17a-11, as proposed to be amended.

¹³⁷⁹ Compare paragraph (e) of proposed Rule 18a-8, with paragraph (d) of Rule 17a-11, as proposed to be amended. The Commission notes that paragraph (d) of Rule 17a-11, as proposed to be amended, also requires notification of the discovery of a “material inadequacy” to an over-the-counter derivatives dealer.

similar proposed requirement applicable to broker-dealers for failure to make a required deposit into a security-based swap customer account.¹³⁸⁰

The proposed requirement for a bank SBSB, bank MSBSP, stand-alone SBSB, and stand-alone MSBSP to notify the Commission in the event that it fails to make and keep current its required books and records is modeled on a similar requirement for broker-dealers.¹³⁸¹ The proposed requirement for stand-alone ANC SBSBs to notify the Commission of an insufficient level of liquidity reserves is modeled after a similar requirement for ANC broker-dealer SBSBs.¹³⁸²

With respect to bank SBSBs and bank MSBSPs, the Commission is proposing to include a notification requirement in proposed Rule 18a-8 that would require these entities to give the Commission notice when they file an adjustment of its reported capital category with its prudential regulator by transmitting a copy of the notice to the Commission.¹³⁸³

In general, the Commission preliminarily believes most of the costs stemming from the notification proposals would arise from preparing and filing the notices.¹³⁸⁴

These notices serve an important role in the context of the reporting and recordkeeping rules for broker-dealers, broker-dealer SBSBs, broker-dealer MSBSPs, stand-alone SBSBs, stand-alone MSBSPs, bank SBSBs, and bank MSBSPs because they serve to alert the Commission to the fact that certain events are occurring at a registrant that are highly relevant to the registrant's overall ability to continue to meet its obligations to customers and counterparties.

¹³⁸⁰ Compare paragraph (g) of proposed Rule 18a-8, with paragraph (f) of Rule 17a-11, as proposed to be amended.

¹³⁸¹ Compare paragraph (d) of proposed Rule 18a-8, with paragraph (c) Rule 17a-11, as proposed to be amended.

¹³⁸² Compare paragraph (f) of proposed Rule 18a-8, with paragraph (e) Rule 17a-11, as proposed to be amended.

¹³⁸³ See *supra* section II.C.2. See also paragraph (c) of proposed Rule 18a-8.

¹³⁸⁴ See *infra* section V.E.

For example, a report of a capital deficiency would alert the Commission to the fact that a registrant may lack sufficient capital to continue to operate its business and meet its obligations to customers and counterparties. The notification requirements are thus critical to helping the Commission fulfill its statutory responsibility to monitor whether SBSDs and MSBSPs are operating in compliance with the Exchange Act and the rules thereunder.¹³⁸⁵

In order to aid its analysis, the Commission generally requests comment about the general costs and benefits of the Rule 17a-11, as proposed to be amended, and proposed Rule 18a-8. The Commission requests data to evaluate the costs and benefits of the proposals.

7. Quarterly Securities Count

As discussed in greater detail above,¹³⁸⁶ the Commission is also proposing to establish a securities count program for SBSDs under sections 15F and 17(a) of the Exchange Act that is modeled on Rule 17a-13's securities count program for broker-dealers. More specifically, stand-alone SBSDs would be subject to proposed Rule 18a-9. For reasons explained above, proposed Rule 18a-9 would not apply to stand-alone MSBSPs, bank SBSDs, or bank MSBSPs.¹³⁸⁷

Paragraph (b) of Rule 17a-13 prescribes the requirement to perform a quarterly securities count and specifies the steps a broker-dealer must take in performing a count. Paragraph (c) of Rule 17a-13 prescribes the timing of the count, permitting a broker-dealer to perform the securities count on a rolling basis throughout the quarter as opposed to all in one day. Paragraph (d) of Rule 17a-13 provides that the examination, count, verification, and comparison performed under the rule must be done by persons whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of

¹³⁸⁵ See 15 U.S.C. 78o-10(f).

¹³⁸⁶ See *supra* section II.D.1.

¹³⁸⁷ *Id.*

the subject records. Proposed Rule 18a-9 applies substantially all the same affirmative obligations to stand-alone SBSDs that apply to broker-dealers under Rule 17a-13.¹³⁸⁸

As was discussed above,¹³⁸⁹ Rule 17a-13, the model for proposed Rule 18a-9, arose in the aftermath of the 1967-1970 securities industry crisis where deficiencies in broker-dealers' internal controls and procedures for, among other things, failing to adequately check and count securities, created a serious "paper work crisis" in the securities markets.¹³⁹⁰ The Commission preliminarily believes that instituting a parallel provision could help to avoid a similar problem for stand-alone SBSDs. Moreover, the Commission preliminarily believes that to the extent a stand-alone SBSD has not invested in the technology necessary to help ensure that it can accurately track and safeguard securities, the proposed rule will require such investments to be made,¹³⁹¹ which could improve the quality of such tracking and safeguarding.

The Commission preliminarily believes most of the negative economic effects stemming from the securities count proposal would arise from regulatory and compliance costs. The Commission believes that the costs involved, and any larger economic effects, should be similar to those associated with Rule 17a-13 and would be related primarily to the development and maintenance of internal procedures and controls and the investment in technology.¹³⁹²

The Commission generally requests comment about its analysis of the general costs and benefits of the proposed securities count rules for stand-alone SBSDs. The Commission requests data to assess the costs and benefits of the proposals for the stand-alone SBSDs.

¹³⁸⁸ Compare proposed Rule 18a-9, with 17 CFR 240.17a-13. Proposed Rule 18a-9 omits the exemptions from applicability of the rule that appear in paragraphs (a)(1), (a)(2), (a)(3), and (e) of Rule 17a-13 because those exemptions relate to broker-dealer-specific functions and broker-dealer registration status. See 17 CFR 240.17a-13(a) and (e).

¹³⁸⁹ See *supra* section II.D.1.

¹³⁹⁰ *Id.*

¹³⁹¹ See *infra* section V.E.

¹³⁹² *Id.*

D. Impact on Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act provides that whenever the Commission engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.¹³⁹³ In addition, section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.¹³⁹⁴ Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.¹³⁹⁵ As stated above, the Commission believes that the recordkeeping, reporting, notification, and securities count rules and rule amendments being proposed today address, among other things, the documentation, reporting, and evidence of compliance with the capital, margin, and segregation rules. Thus, the Commission believes that these rules, by their nature, will have a more limited economic impact as compared to the Commission's capital, margin, and segregation proposals.¹³⁹⁶ Thus, while the Commission would expect that the adoption of these proposed rules and rule amendments, and their attendant benefits and costs, would affect competition, efficiency, and capital formation, the Commission preliminarily believes that such impact will be more limited than the impact from the capital, margin, and segregation proposals. In most instances, the Commission believes the costs will consist of the implementation-related costs of the proposed rules and rule amendments and the

¹³⁹³ See 15 U.S.C. 78c(f).

¹³⁹⁴ See 15 U.S.C. 78w(a)(2).

¹³⁹⁵ *Id.*

¹³⁹⁶ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70213.

benefits will be those that stem from enabling the Commission to evaluate whether SBSDs and MSBSPs are in compliance with the financial responsibility rules governing security-based swap activities. The Commission requests comment on its analysis and underlying assumptions in this regard.

In the aggregate, the proposed recordkeeping, reporting, and notification rules would be an integral part of the proposed financial responsibility rules governing security-based swaps. The rules are designed to provide greater regulatory transparency into the business activities of these firms and to assist the Commission and other regulators in reviewing and monitoring compliance with the capital, margin, and segregation requirements. In general, the Commission believes that the proposals would thus help ensure that firms that engage in security-based swap activity do so in a financially responsible manner. The Commission further believes that the proposed rules and rule amendments, by improving its ability to monitor the financial condition of these registrants, could contribute to confidence in the market and willingness of market participants to engage in activities. It is the Commission staff's experience that greater confidence in a market promotes greater participation, leading to increased competition and efficiency, which have a positive effect on capital formation in the security-based swap market.

The Commission is cognizant, however, that it must be sensitive to the costs and burdens imposed by its rules. For example, overly restrictive or costly recordkeeping requirements could reduce the willingness of firms to engage in such trading. This could, in turn, increase transaction costs for market participants and contribute to less liquidity in the market. Even if the cost of overly restrictive recordkeeping, reporting, notification, and securities count requirements were shouldered only by those market participants that are subject to them, the excess compliance costs incurred would not be available for potentially more efficient uses,

which thereby could distort capital allocation and, in turn, adversely affect capital formation. The Commission preliminarily believes the proposed recordkeeping, reporting, securities count, and notification proposals are unlikely to materially increase the barriers to entry in this market.

As described in more detail above, broker-dealers historically have not participated in a significant way in security-based swap trading, in part, because the existing broker-dealer capital requirements make it relatively costly to conduct these activities in broker-dealers. As stated above, the Commission estimates that approximately seventeen broker-dealers will register as SBSDs or MSBSPs and approximately twenty-five registered broker-dealers will be engaged in security-based swap activities but would not be required to register as an SBSD or MSBSP.¹³⁹⁷ In addition, a broker-dealer may elect to register an affiliated entity as an SBSD or MSBSP, instead of registering the broker-dealer itself as an SBSD or MSBSP. A market participant unaffiliated with a broker-dealer, including a bank, which conducts security-based swap activity in the U.S. may also register as an SBSD or MSBSP. As stated above, the Commission estimates that approximately thirty-four such entities will register as SBSDs or MSBSPs.¹³⁹⁸ As discussed above, as of April 1, 2013, there were 4,545 broker-dealers registered with the Commission.

To the extent that the proposed rules are burdensome or costly, they may impact the incentives of market participants in terms of whether they seek to register as SBSDs or MSBSPs. If fewer firms register, this could adversely impact competition and the overall efficiency of the U.S. capital markets as fewer firms will conduct security-based swap activities in the U.S. For example, excessive costs could discourage firms from engaging in security-based swap trading, which would reduce competition among market participants, thereby leading to lower liquidity,

¹³⁹⁷ See supra section IV.C.

¹³⁹⁸ Id.

impeded price discovery, and higher transaction costs, all of which are characteristics of reduced levels of efficiency in the market. Moreover, it is possible that cost increases could lead to certain broker-dealers ceasing to engage in security-based swap trading, which could then reduce competition and impose inefficiency costs on the security-based swap marketplace. At the same time, these market participants may seek to conduct the security-based swap business in jurisdictions where regulations are, or are perceived to be, less burdensome.

In order to assist its evaluation of the proposed rules and rule amendments' effects on efficiency, competition, and capital formation, the Commission requests comment. Commenters are asked to be as specific as possible in identifying those rule proposals that are particularly beneficial or problematic, as the case may be, and in identifying alternative approaches or other ways in which the harmful effect(s) of the proposals can be ameliorated or eliminated.

E. Implementation Considerations

The proposed new rules and rule amendments, as discussed above, would impose certain implementation burdens and related costs on SBSDs and MSBSPs, as well as broker-dealers. These costs may include start-up costs, including personnel and other costs, such as technology costs, to comply with the proposed new rules and rule amendments. The Commission understands that entities that will engage in security-based swap transactions currently incur costs during their normal business activities and the proposed new rules would impose incremental costs. While they are not negligible, the Commission preliminarily believes, as discussed above, that they are unlikely to materially increase costs.

Based on section IV.D. of this release, the Commission has estimated the related costs of these implementation requirements for SBSDs, MSBSPs, and broker-dealers.¹³⁹⁹ The

¹³⁹⁹

See section IV.D. of this release (discussing total initial and annual recordkeeping and reporting burdens of the proposed rules and rule amendments).

Commission estimates for all SBSDs and MSBSPs, these initial implementation costs to be approximately \$10 million and the ongoing costs of implementation to be approximately \$9 million, as summarized in more detail below.¹⁴⁰⁰

Rule 17a-3, which requires broker-dealers to make and keep current certain records, would be amended to account for security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs.¹⁴⁰¹ The Commission is also proposing to add new provisions to Rule 17a-3 that would relate to the recently proposed margin requirements applicable to SBSDs.¹⁴⁰² Across all types of broker-dealers, including broker-dealers not registered as SBSDs or MSBSPs, the requirements are estimated to impose a one-time and annual aggregate cost of approximately \$925,360¹⁴⁰³ and \$282,807, respectively.¹⁴⁰⁴

The Commission is proposing new Rule 18a-5 – which is modeled on Rule 17a-3, as proposed to be amended – to require stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs to make and keep current certain records.¹⁴⁰⁵ The Commission estimates that

¹⁴⁰⁰ The Commission has also proposed technical amendments which it estimates will not impose material additional costs.

¹⁴⁰¹ See, e.g., paragraph (a)(1) of Rule 17a-3, as proposed to be amended (proposed addition of information that must be included in security-based swap purchase and sale blotters).

¹⁴⁰² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR at 70257–70274 (proposed margin requirements applicable to SBSDs).

¹⁴⁰³ 3,440 hours x \$269/hour national hourly rate for a compliance manager = \$925,360. See supra section IV.D.1. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-3). The \$269 per hour figure for a compliance manager is from SIFMA's Management & Professional Earnings in the Securities Industry 2012, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

¹⁴⁰⁴ 4,489 hours x \$63/hour national hourly rate for a compliance clerk = \$282,807. See supra section IV.D.1. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-3). The \$63 per hour figure for a compliance clerk is from SIFMA's Management & Professional Earnings in the Securities Industry 2012, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

¹⁴⁰⁵ See supra section II.A.2.a. (describing proposed Rule 18a-5).

proposed Rule 18a-5 would result in total initial industry cost of \$2,848,260 to SBSDs and MSBSPs not registered as broker-dealers.¹⁴⁰⁶ On an annual basis, the Commission estimates that proposed Rule 18a-5 would result in \$890,475 of total industry costs to SBSDs and MSBSPs not registered as broker-dealers.¹⁴⁰⁷

As discussed above, the Commission is proposing amendments to Rule 17a-4 to account for the security-based swap activities of broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, as well as certain largely non-substantive technical amendments.¹⁴⁰⁸ The Commission estimates that the proposed amendments to Rule 17a-4 would result in a total initial industry cost of \$1,167,452 to broker-dealers.¹⁴⁰⁹ On an annual basis, the Commission estimates that the proposed amendments to Rule 17a-4 would result in \$174,388 of total annual aggregate industry costs to broker-dealers.¹⁴¹⁰

The Commission is proposing new Rule 18a-6 – modeled on Rule 17a-4, as proposed to be amended – to establish record preservation requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs. The Commission estimates proposed Rule 18a-6

¹⁴⁰⁶ (10,540 hours x \$269/hour national hourly rate for a compliance manager) + \$13,000 in external costs = \$2,848,260. See supra section IV.D.1. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed Rule 18a-5).

¹⁴⁰⁷ (13,175 hours x \$63/hour national hourly rate for a compliance clerk) + \$60,450 in external costs = \$890,475. See supra section IV.D.1. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed Rule 18a-5).

¹⁴⁰⁸ See supra section II.A.3.a.

¹⁴⁰⁹ 3,718 hours x \$314/hour national hourly rate for a senior database administrator = \$1,167,452. See supra section IV.D.2. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-4). The \$314 per hour figure for a senior database administrator is from SIFMA's Management & Professional Earnings in the Securities Industry 2012, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

¹⁴¹⁰ (1,716 hours x \$63/hour national hourly rate for a compliance clerk) + \$66,280 in external costs = \$174,388. See supra section IV.D.2. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-4).

would result in \$4,054,996 of initial costs to the industry¹⁴¹¹ and \$1,038,660 of annual costs to the industry.¹⁴¹²

As stated above, the Commission is proposing to amend Rule 17a-5, to require broker-dealer SBSDs and broker-dealer MSBSPs to file proposed Form SBS, instead of a particular part of the FOCUS Report.¹⁴¹³ The Commission is also proposing amendments to Rule 17a-5 to require additional information about the broker-dealer's security-based swap activity in the financial report filed by broker-dealers,¹⁴¹⁴ and to require ANC broker-dealers to report to the Commission the results of the liquidity stress test on a monthly basis.¹⁴¹⁵ The Commission estimates that the amendments to Rule 17a-5 would result in an initial total cost of \$158,710 to broker-dealers.¹⁴¹⁶ On an annual basis, the Commission estimates that the amendments to Rule 17a-5 would result in \$1,089,450 of total annual costs to broker-dealers.¹⁴¹⁷

The Commission is proposing Rule 18a-7 to provide reporting requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs that are analogous to the reporting requirements proposed for broker-dealer SBSDs and broker-dealer MSBSPs. Proposed Rule 18a-7 would also require stand-alone SBSDs and stand-alone MSBSPs to file with the

¹⁴¹¹ 12,914 hours x \$314/hour national hourly rate for a senior database administrator = \$4,054,996.

¹⁴¹² (9,780 hours x \$63/hour national hourly rate for a compliance clerk) + (38 hours x \$379/hour for national hourly rate for an attorney) + \$204,078 in external costs = \$1,038,660.

¹⁴¹³ See supra section II.B.2.b.

¹⁴¹⁴ Compare, e.g., FOCUS Report Part II CSE, Statement of Financial Condition, Line 22, with Form SBS, Statement of Financial Condition, Line 22.

¹⁴¹⁵ See paragraph (a)(5)(vii) of Rule 17a-5, as proposed to be amended.

¹⁴¹⁶ 590 hours x \$269/hour national hourly rate for a compliance manager = \$158,710. See supra section IV.D.3. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-5). The majority of costs that broker-dealers would incur as a result of the amendments to Rule 17a-5 are expected to result from the additional information elicited in Form SBS, as compared to the FOCUS Report. Because broker-dealers would be required to file Form SBS on an ongoing basis, it is characterized as an annual cost, rather than an initial cost.

¹⁴¹⁷ 4,050 hours x \$269/hour national hourly rate for a compliance manager = \$1,089,450. See supra section IV.D.3. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-5).

Commission an audited annual report, as described above.¹⁴¹⁸ The Commission estimates that proposed Rule 18a-7 would result in an initial industry cost of \$777,410.¹⁴¹⁹ The Commission estimates that proposed Rule 18a-7 would result in an annual industry cost of \$5,500,693.24.¹⁴²⁰

As described in more detail above, the Commission is proposing to establish notification requirements to require SBSs and MSBSs to timely notify the Commission of potential problems at these registrants.¹⁴²¹ The Commission is proposing to amend Rule 17a-11 to add certain notification requirements for broker-dealer SBSs and broker-dealer MSBSs. In the aggregate, the Commission expects the proposed amendments to Rule 17a-11 to result in an annual industry cost of \$29,859 to broker-dealer SBSs and broker-dealer MSBSs.¹⁴²²

The Commission is also proposing Rule 18a-8 to establish reporting requirements for stand-alone SBSs and stand-alone MSBSs that are analogous to the reporting requirements for broker-dealer SBSs and broker-dealer MSBSs, as well as a separate notification requirement for bank SBSs and bank MSBSs. The Commission expects that proposed Rule 18a-8 would

¹⁴¹⁸ See supra section II.B.3. (filing of annual audited reports and other reports).

¹⁴¹⁹ 2,890 hours x \$269/hour national hourly rate for a compliance manager = \$777,410. See supra section IV.D.3. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-5 and proposed Rule 18a-7). The majority of costs SBSs and MSBSs would incur as a result of proposed Rule 18a-7 is expected to result from the information elicited in Form SBS and the required annual audit. Because the additional information in the Form SBS and the annual audit would be required on an ongoing basis, the Commission is characterizing them as ongoing costs.

¹⁴²⁰ (3,978 hours x \$63/hour national hourly rate for a compliance clerk) + \$5,250,079 in external costs = \$5,500,693. See supra section IV.D.3. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-5 and proposed Rule 18a-7).

¹⁴²¹ See supra section II.C.2. (proposed amendments to Rule 17a-11 and proposed Rule 18a-7).

¹⁴²² (100 hours + 10 hours + 1 hour) x \$269/hour national hourly rate for a compliance manager = \$29,859. See supra section IV.D.4. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-11 and proposed Rule 18a-8).

result in an annual industry cost of \$1,237 to stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs.¹⁴²³

Proposed Rule 18a-9, which is modeled on Rule 17a-13, would require stand-alone SBSDs to establish a securities count program.¹⁴²⁴ The Commission estimates that proposed Rule 18a-9 would impose an initial industry-wide cost of \$76,725¹⁴²⁵ and an industry-wide annual cost of \$113,400 per year.¹⁴²⁶

VI. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Regulatory Flexibility Act ("RFA")¹⁴²⁷ requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)¹⁴²⁸ of the Administrative Procedure Act,¹⁴²⁹ as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."¹⁴³⁰ Section 605(b) of the RFA

¹⁴²³ 4.6 hours x \$269/hour national hourly rate for a compliance manager = \$1,237. *See supra* section IV.D.4. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed amendments to Rule 17a-11 and proposed Rule 18a-8).

¹⁴²⁴ *See supra* section II.D.

¹⁴²⁵ 225 hours x \$341/hour national hourly rate for a senior operations manager = \$76,725. *See supra* section IV.D.5. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed Rule 18a-9). The \$341 per hour figure for a senior operations manager is from SIFMA's *Management & Professional Earnings in the Securities Industry 2012*, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

¹⁴²⁶ 900 hours x \$126/hour national hourly rate for an operations specialist = \$113,400. *See supra* section IV.D.5. (PRA estimate of the total initial and annual recordkeeping and reporting burden for proposed Rule 18a-9). The \$126 per hour figure for an operations specialist is from SIFMA's *Management & Professional Earnings in the Securities Industry 2012*, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

¹⁴²⁷ *See* 5 U.S.C. 601 *et seq.*

¹⁴²⁸ *See* 5 U.S.C. 603(a).

¹⁴²⁹ *See* 5 U.S.C. 551 *et seq.*

¹⁴³⁰ Although section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this

states that this requirement shall not apply to any proposed rule or proposed rule amendment, which, if adopted, would not have a significant economic impact on a substantial number of small entities.¹⁴³¹

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of \$5 million or less,¹⁴³² or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,¹⁴³³ or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.¹⁴³⁴ Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (1) for entities in credit intermediation and related activities,¹⁴³⁵ firms with \$175 million or less in assets; (2) for non-depository credit intermediation and certain

proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Statement of Management on Internal Accounting Control, Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

¹⁴³¹ See 5 U.S.C. 605(b).

¹⁴³² See 17 CFR 240.0-10(a).

¹⁴³³ See 17 CFR 240.17a-5(d).

¹⁴³⁴ See 17 CFR 240.0-10(c).

¹⁴³⁵ Including commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing.

other activities,¹⁴³⁶ firms with \$7 million or less in annual receipts; (3) for entities in financial investments and related activities,¹⁴³⁷ firms with \$7 million or less in annual receipts; (4) for insurance carriers and entities in related activities,¹⁴³⁸ firms with \$7 million or less in annual receipts; and (5) for funds, trusts, and other financial vehicles,¹⁴³⁹ firms with \$7 million or less in annual receipts.¹⁴⁴⁰

Based on available information about the security-based swap market, the market, while broad in scope, is largely dominated by entities such as those that would be covered by the SBSD and MSBSP definitions. Subject to certain exceptions, section 3(a)(71)(A) of the Exchange Act defines security-based swap dealer to mean any person who: (1) holds itself out as a dealer in security-based swaps; (2) makes a market in security-based swaps; (3) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (4) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. Section 3(a)(67)(A) of the Exchange Act defines major security-based swap participant to be any person: (1) who is not an SBSD; and (2) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging

¹⁴³⁶ Including firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve and clearing house activities, and other activities related to credit intermediation.

¹⁴³⁷ Including firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities.

¹⁴³⁸ Including direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and pension funds, and all other insurance related activities.

¹⁴³⁹ Including pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts, and other financial vehicles.

¹⁴⁴⁰ See 13 CFR 121.201.

or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or that is a financial entity that is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate federal banking regulator; and maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.¹⁴⁴¹

Based on feedback from industry participants about the security-based swap markets, entities that will qualify as SBSDs and MSBSPs, whether registered broker-dealers or not, will likely exceed the thresholds defining “small entities” set out above. Thus, it is unlikely that the requirements applicable to SBSD and MSBSPs that would be established under the proposed amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11, and proposed new Rules 18a-5, 18a-6, 18a-7 and 18a-8 and 18a-9, would have a significant economic impact on any small entity.

The Commission estimates that there are approximately 735 broker-dealers that were “small” for the purposes Rule 0-10.¹⁴⁴² The amendments to Rules 17a-3, 17a-4, and 17a-5

¹⁴⁴¹ See also Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 FR at 30743 (“The SEC continues to believe that the types of entities that would engage in more than a de minimis amount of dealing activity involving security-based swaps – which generally would be major banks – would not be ‘small entities’ for purposes of the RFA. Similarly, the SEC continues to believe that the types of entities that may have security-based swap positions above the level required to be a ‘major security-based swap participant’ would not be a ‘small entity’ for purposes of the RFA. Accordingly, the SEC certifies that the final rules defining ‘security-based swap dealer’ or ‘major security-based swap participant’ would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.”).

¹⁴⁴² This estimate is based on the number of small broker-dealers as of December 31, 2012.

relating to making and keeping records that include details about security-based swaps and swaps and reporting information about security-based swaps and swaps would apply to all broker-dealers with such positions. These proposed amendments, therefore, would apply to all “small” broker-dealers in that they would be subject to the requirements in the proposed amendments. It is likely, however, that these proposed amendments would have no, or little, impact on “small” broker-dealers, since most, if not all, of these firms generally would not hold these types of positions. In addition, the technical amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11 would apply to all broker-dealers, including broker-dealers that are small. However, these amendments would have no impact on broker-dealers, including “small” broker-dealers, because they would not establish new substantive requirements.

For the foregoing reasons, the Commission certifies that the proposed amendments to Rules 17a-3, 17a-4, 17a-5, and 17a-11, and new Rules 18a-5 through 18a-9, would not have a significant economic impact on any small entity for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

Under the Small Business Regulatory Enforcement Fairness Act of 1996,¹⁴⁴³ a rule is considered “major” where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment, or innovation. The Commission requests comment on the

¹⁴⁴³ See Contract with America Advancement Act of 1996, Pub. L. 104-121, 110 Stat. 847 (1996) (codified in various sections of titles 5 and 15 of the U.S. Code, and as a note to 5 U.S.C. 601).

potential impact of the proposed rule on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

VIII. STATUTORY BASIS AND TEXT OF THE PROPOSED AMENDMENTS AND NEW RULES

The Commission is proposing to revise Rules 17a-3, 17a-4, 17a-5, and 17a-11 under the Exchange Act (17 CFR 240.17a-3, 17 CFR 240.17a-4, 17 CFR 240.17a-5, and 17 CFR 240.17a-11), proposing to revise Rule 18a-1 under the Exchange Act (17 CFR 240.18a-1) [as proposed at 77 FR 70214, Nov. 23, 2012], and proposing to add new Rules 18a-5, 18a-6, 18a-7, and 18a-8 under the Exchange Act (17 CFR 240.18a-5, 17 CFR 240.18a-6, 17 CFR 240.18a-7, and 17 CFR 240.18a-8), and FOCUS Report Form SBS (17 CFR 249.617) pursuant to the authority conferred by the Exchange Act, including sections 15F, 17, 23(a) and 36.¹⁴⁴⁴

List of Subjects in 17 CFR Parts 240 and 249

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

Text of the Amendments

For the reasons set out in the preamble, the Commission proposes to revise Title 17, Chapter II, of the Code of Federal Regulations as follows:

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

1. The general authority citation for part 240 is revised to read, in part, as follows:

¹⁴⁴⁴

15 U.S.C. 78o-10, 78q, 78w(a), and 78mm.

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

2. Section 240.17a-3 is amended by:
 - a. Revising the heading;
 - b. Adding an undesignated introductory paragraph;
 - c. Revising paragraphs (a) introductory text, (a)(1), (a)(3), (a)(4)(vi), (a)(4)(vii), (a)(5), (a)(6), (a)(7), (a)(8), (a)(9), (a)(10), (a)(11), (a)(12)(i) introductory text, (a)(12)(i)(A), (a)(12)(i)(E), (a)(12)(i)(F), (a)(12)(i)(G), (a)(12)(i)(H);
 - d. Removing the undesignated proviso paragraph at the end of paragraph (a)(12)(i);
 - e. Adding a note at the end of paragraph (a)(12)(i);
 - f. Revising paragraph (a)(12)(ii);
 - g. In paragraphs (a)(16)(ii)(A) and (B), removing the phrase “shall mean” and adding in its place “means”;
 - h. In paragraphs (a)(17)(i)(A), (B), (C) and (D), (a)(18), (a)(19), (a)(20) and (a)(22), removing “member,” wherever it appears;
 - i. In paragraphs (a)(17)(i)(A) and (B)(1), (a)(18)(i), and (a)(19)(i), removing the word “shall” and adding in its place “must” wherever it appears;

- j. In paragraphs (a)(17)(i)(C) and (D), removing the word "shall" and adding in its place "will" wherever it appears;
 - k. Adding paragraphs (a)(24), (a)(25), (a)(26), (a)(27), (a)(28), (a)(29), and (a)(30);
 - l. Revising paragraph (b);
 - m. Removing paragraphs (c) and (d);
 - n. Redesignating paragraphs (e), (f), (g), and (h) as (c), (d), (e), and (f), respectively;
- and
- o. Revising newly redesignated paragraphs (c), (d), (e), (f)(2), (f)(3), and (f)(4).

The additions and revisions read as follows:

§ 240.17a-3 -- Records to be made by certain brokers and dealers.

Section 240.17a-3 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o-8(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the books and records requirements under § 240.18a-5.

(a) Every broker or dealer must make and keep current the following books and records relating to its business:

(1) Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities (including security-based swaps), all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records must show the account for which each such purchase or sale was effected, the name and amount of securities, the unit and aggregate purchase or sale price (if

any), the trade date, and the name or other designation of the person from whom such securities were purchased or received or to whom sold or delivered. For security-based swaps, such records must also show, for each purchase or sale, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(2) * * *

(3) Ledger accounts (or other records) itemizing separately as to each cash, margin, or security-based swap account of every customer and of such broker or dealer and partners thereof, all purchases, sales, receipts and deliveries of securities (including security-based swaps) and commodities for such account, and all other debits and credits to such account; and, in addition, for a security-based swap, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(4) * * *

(vi) All long and all short securities record differences arising from the examination, count, verification, and comparison pursuant to §§ 240.17a-5, 240.17a-12, and 240.17a-13 (by date of examination, count, verification, and comparison showing for each security the number of long or short count differences); and

(vii) Repurchase and reverse repurchase agreements.

(5) A securities record or ledger reflecting separately for each:

(i) Security, other than a security-based swap, as of the clearance dates all "long" or "short" positions (including securities in safekeeping and securities that are the subjects of

repurchase or reverse repurchase agreements) carried by such broker or dealer for its account or for the account of its customers or partners, or others, and showing the location of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried.

(ii) Security-based swap, the reference security, index, or obligor, the unique transaction identifier, the unique counterparty identifier, whether it is a "long" or "short" position in the security-based swap, whether the security-based swap is cleared or not cleared, and if cleared, identification of the clearing agency where the security-based swap is cleared.

(6)(i) A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security, except for the purchase or sale of a security-based swap, whether executed or unexecuted.

(A) The memorandum must show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time the order was received, the time of entry, the price at which executed, the identity of each associated person, if any, responsible for the account, the identity of any other person who entered or accepted the order on behalf of the customer, or, if a customer entered the order on an electronic system, a notation of that entry, and, to the extent feasible, the time of execution or cancellation. The memorandum need not show the identity of any person, other than the associated person responsible for the account, who may have entered or accepted the order if the order is entered into an electronic system that generates the memorandum and if that system is not capable of receiving an entry of the identity of any person other than the responsible associated person; in

that circumstance, the broker or dealer must produce upon request by a representative of a securities regulatory authority a separate record which identifies each other person. An order entered pursuant to the exercise of discretionary authority by the broker or dealer, or associated person thereof, must be so designated. The term *instruction* must include instructions between partners and employees of a broker or dealer. The term *time of entry* means the time when the broker or dealer transmits the order or instruction for execution.

(B) The memorandum need not be made as to a purchase, sale or redemption of a security on a subscription way basis directly from or to the issuer, if the broker or dealer maintains a copy of the customer's or non-customer's subscription agreement regarding a purchase, or a copy of any other document required by the issuer regarding a sale or redemption.

(ii) A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security-based swap, whether executed or unexecuted. The memorandum must show the terms and conditions of the order or instructions and of any modification or cancellation thereof; the account for which entered; the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer, or, if a customer entered the order on an electronic system, a notation of that entry; and, to the extent feasible, the time of cancellation, if applicable. The memorandum also must include the type of the security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier. An order entered pursuant to the exercise of discretionary authority must be so designated.

(7)(i) A memorandum of each purchase or sale of a security, other than for the purchase or sale of a security-based swap, for the account of the broker or dealer showing the price and, to the extent feasible, the time of execution; and, in addition, where the purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt; the terms and conditions of the order and of any modification thereof; the account for which it was entered; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer, or, if a customer entered the order on an electronic system, a notation of that entry. The memorandum need not show the identity of any person other than the associated person responsible for the account who may have entered the order if the order is entered into an electronic system that generates the memorandum and if that system is not capable of receiving an entry of the identity of any person other than the responsible associated person. In that circumstance, the broker or dealer must produce upon request by a representative of a securities regulatory authority a separate record that identifies each other person. An order with a customer other than a broker or dealer entered pursuant to the exercise of discretionary authority by the broker or dealer, or associated person thereof, must be so designated.

(ii) A memorandum of each purchase or sale of a security-based swap for the account of the broker or dealer showing the price; and, in addition, where the purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt; the terms and conditions of the order and of any modification thereof; the account for which it was entered; the identity of any other person who entered or accepted the order on behalf of the customer, or, if a customer entered the order on an electronic system, a notation of that entry. The memorandum must also include the type of security-based swap, the reference

security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier. An order entered pursuant to the exercise of discretionary authority must be so designated.

(8)(i) With respect to a security other than a security-based swap, copies of confirmations of all purchases and sales of securities, including all repurchase and reverse repurchase agreements, and copies of notices of all other debits and credits for securities, cash and other items for the account of customers and partners of such broker or dealer.

(ii) With respect to a security-based swap, copies of the security-based swap trade acknowledgement and verification made in compliance with § 240.15Fi-1 [previously proposed at 76 FR 3859, Jan. 21, 2011].

(9) A record with respect to each cash, margin, and security-based swap account with such broker or dealer indicating, as applicable:

(i) The name and address of the beneficial owner of such account,

(ii) Except with respect to exempt employee benefit plan securities as defined in § 240.14a-1(d), but only to the extent such securities are held by employee benefit plans established by the issuer of the securities, whether or not the beneficial owner of securities registered in the name of such brokers or dealers, or a registered clearing agency or its nominee objects to disclosure of his or her identity, address, and securities positions to issuers,

(iii) In the case of a margin account, the signature of such owner; *Provided*, That, in the case of a joint account or an account of a corporation, such records are required only in respect of the person or persons authorized to transact business for such account, and

(iv) In the case of a security-based swap account, a record of the unique counterparty identifier, the name and address of such counterparty, and the signature of each person authorized to transact business in the security-based swap account.

(10) A record of all puts, calls, spreads, straddles, and other options in which such broker or dealer has any direct or indirect interest or which such broker or dealer, has granted or guaranteed, containing, at least, an identification of the security, and the number of units involved. An OTC derivatives dealer must also keep a record of all eligible OTC derivative instruments as defined in § 240.3b-13 in which the OTC derivatives dealer has any direct or indirect interest or which it has written or guaranteed, containing, at a minimum, an identification of the security or other instrument, the number of units involved, and the identity of the counterparty.

(11) A record of the proof of money balances of all ledger accounts in the form of trial balances and a record of the computation of aggregate indebtedness and net capital, as of the trial balance date, pursuant to § 240.15c3-1. The computation need not be made by any broker or dealer unconditionally exempt from § 240.15c3-1 by paragraph § 240.15c3-1(b)(1) or (b)(3). Such trial balances and computations must be prepared currently at least once a month.

(12)(i) A questionnaire or application for employment executed by each associated person (as defined in paragraph (f)(4) of this section) of the broker or dealer, which questionnaire or application must be approved in writing by an authorized representative of the broker or dealer and must contain at least the following information with respect to the associated person:

(A) The associated person's name, address, social security number, and the starting date of the associated person's employment or other association with the broker or dealer;

* * * * *

(E) A record of any denial, suspension, expulsion, or revocation of membership or registration of any broker or dealer with which the associated person was associated in any capacity when such action was taken;

(F) A record of any permanent or temporary injunction entered against the associated person or any broker or dealer with which the associated person was associated in any capacity at the time such injunction was entered;

(G) A record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities, commodities, banking, insurance or real estate (including, but not limited to, acting or being associated with a broker or dealer, investment company, investment adviser, futures sponsor, bank, or savings and loan association), fraud, false statements or omissions, wrongful taking of property, bribery, forgery, counterfeiting, or extortion, and the disposition of the foregoing; and

(H) A record of any other name or names by which the associated person has been known or which the associated person has used.

Note to paragraph (a)(12)(i). Provided, however, that if such associated person has been registered as a registered representative of such broker or dealer with, or the associated person's employment has been approved by a self-regulatory organization, then retention of a full, correct, and complete copy of any and all applications for such registration or approval will be deemed to satisfy the requirements of this paragraph.

(ii) A record listing every associated person of the broker or dealer which shows, for each associated person, every office of the broker or dealer, where the associated person regularly conducts the business of handling funds or securities or effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security for the broker or dealer and the

Central Registration Depository number, if any, and every internal identification number or code assigned to that person by the broker or dealer.

* * * * *

(24) A report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under § 240.15c3-1(f), if applicable.

(25) A record of the daily calculation of the amount of equity and, if applicable, the margin amount for each account of a counterparty required under § 240.18a-3(c) [previously proposed at 77 FR 70214, Nov. 23, 2012].

(26) A record of compliance with possession or control requirements under § 240.18a-4(b) [previously proposed at 77 FR 70214, Nov. 23, 2012].

(27) A record of the reserve computation required under § 240.18a-4(c) [previously proposed at 77 FR 70214, Nov. 23, 2012].

(28) A record of each security-based swap transaction that is not verified under § 240.15Fi-1 [previously proposed at 76 FR 3859, Jan. 21, 2011] within five business days of execution that includes, at a minimum, the unique transaction identifier and unique counterparty identifier.

(29) A record that demonstrates the broker or dealer has complied with the business conduct standards as required under § 240.15Fh-6 [previously proposed at 76 FR 42396, July 18, 2011].

(30) A record that demonstrates the broker or dealer has complied with the business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-5 and § 240.15Fk-1 [previously proposed at 76 FR 42396, July 18, 2011].

(b) A broker or dealer registered pursuant to Section 15 of the Act (15 U.S.C. 78o), that introduces accounts on a fully-disclosed basis, is not required to make or keep such records of transactions cleared for such broker or dealer as are made and kept by a clearing broker or dealer pursuant to the requirements of §§ 240.17a-3 and 17a-4. Nothing herein contained will be deemed to relieve such broker or dealer from the responsibility that such books and records be accurately maintained and preserved as specified in §§ 240.17a-3 and 17a-4.

(c) For purposes of transactions in municipal securities by municipal securities brokers and municipal securities dealers, compliance with Rule G-8 of the Municipal Securities Rulemaking Board or any successor rule will be deemed to be in compliance with this section.

(d) Security futures products. The provisions of this section will not apply to security futures product transactions and positions in a futures account (as that term is defined in § 240.15c3-3(a)(15)); provided, that the Commodity Futures Trading Commission's recordkeeping rules apply to those transactions and positions.

(e) Every broker or dealer must make and keep current, as to each office, the books and records described in paragraphs (a)(1), (a)(6), (a)(7), (a)(12), (a)(17), (a)(18)(i), (a)(19), (a)(20), (a)(21), and (a)(22) of this section.

(f) * * *

(1) * * *

(2) The term principal means any individual registered with a registered national securities association as a principal or branch manager of a broker or dealer or any other person who has been delegated supervisory responsibility over associated persons by the broker or dealer.

(3) The term securities regulatory authority means the Commission, any self-regulatory organization, or any securities commission (or any agency or office performing like functions) of the States; the Commodities Futures Trading Commission and a prudential regulator to the extent the prudential regulator oversees security-based swap activities.

(4) The term associated person means a "person associated with a broker or dealer" or "person associated with a security-based swap dealer or major security-based swap participant" as defined in sections 3(a)(18) and 3(a)(70) of the Act (15 U.S.C. 78c(a)(18) and (a)(70)) respectively, but will not include persons whose functions are solely clerical or ministerial.

* * * * *

3. Section 240.17a-4 is amended by:

- a. Revising the heading;
- b. Adding an undesignated introductory paragraph;
- c. Revising paragraphs (a), (b) introductory text, (b)(1), (b)(3), (b)(4), (b)(5), (b)(7), (b)(8) introductory text, (b)(8)(i), (b)(8)(v), (b)(8)(vi), (b)(8)(vii), (b)(8)(viii), and (b)(8)(xiii);
- d. Adding paragraph (b)(8)(xvi);
- e. Redesignating paragraph (b)(8)(xv) as paragraph (b)(8)(xvii);
- f. Redesignating paragraph (b)(8)(xiv) as paragraph (b)(8)(xv);
- g. Adding new paragraph (b)(8)(xiv);
- h. Revising newly redesignated paragraph (b)(8)(xv);
- i. In paragraph (b)(11), removing the word "shall" and adding in its place "must";
- j. Adding paragraphs (b)(14), (b)(15), and (b)(16);
- k. Revising paragraphs (c), (d), (e) introductory text, and (e)(1), (e)(2), (e)(3), and (e)(4);

- l. In paragraphs (e)(6), (e)(7), and (e)(8), removing “member,” wherever it appears;
- m. In the last sentence of paragraph (e)(8), removing the word “shall” and adding in its place “must”;
- n. In paragraph (f) introductory text, removing the word “paragraph,” and adding in its place “section”;
- o. In paragraphs (f)(2) introductory text, (f)(2)(i), (f)(2)(ii)(D), and (f)(3) introductory text, removing “member, broker, or dealer” and adding in its place “broker or dealer” wherever it appears;
- p. In paragraph (f)(3)(ii), removing “member, broker or dealer” and adding in its place “broker or dealer”;
- q. In paragraphs (f)(3)(iv)(A), (f)(3)(v) introductory text, (f)(3)(v)(A), and (f)(3)(vi), removing “member, broker, or dealer” and adding in its place “broker or dealer” wherever it appears;
- r. In paragraphs (f)(2) introductory text, (f)(3) introductory text, and (f)(3)(vii), removing the word “shall” and adding in its place “must”;
- s. In paragraph (f)(3)(iv)(B), removing “each index.” and adding in its place “the index.”;
- t. In paragraph (f)(3)(vi), removing the phrase “the self-regulatory organizations” and adding in its place “any self-regulatory organization”;
- u. Revising paragraphs (f)(3)(vii) and (g);
- v. In paragraph (h), adding the phrase “or any successor rule” after the word “Board”.

w. In paragraph (i), removing “member,” wherever it appears, in the first sentence removing the phrase “such outside entity shall” and adding in its place “such outside entity must”, and in the last sentence removing the phrase “Agreement with an outside entity shall” and adding in its place “Agreement with an outside entity will”;

x. In paragraph (j), removing “member,” wherever it appears, removing the phrase “broker and dealer” and adding in its place “broker or dealer”, and removing the word “shall” and adding in its place “must”;

y. In paragraph (k)(1), removing “member,” before “broker or dealer”, and removing the word “shall” and adding in its place “must” wherever it appears;

z. In paragraph (k)(2), removing “member,”;

aa. In paragraph (l) removing “member,” wherever it appears, and removing the phrase § 240.17a-3(g) and adding in its place § 240.17a-3(e);

bb. Revising paragraph (m)(1) through (m)(4); and

cc. Adding paragraph (m)(5).

The additions and revisions read as follows:

§ 240.17a-4 Records to be preserved by certain brokers and dealers.

Section 240.17a-4 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o-8(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the record maintenance and preservation requirements under § 240.18a-6.

(a) Every broker or dealer subject to § 240.17a-3 must preserve for a period of not less than six years, the first two years in an easily accessible place, all records required to be made pursuant to §§ 240.17a-3(a)(1), (a)(2), (a)(3), (a)(5), (a)(21), (a)(22), and analogous records created pursuant to § 240.17a-3(d).

(b) Every broker or dealer subject to § 240.17a-3 must preserve for a period of not less than three years, the first two years in an easily accessible place:

(1) All records required to be made pursuant to § 240.17a-3(a)(4), (a)(6), (a)(7), (a)(8), (a)(9), (a)(10), (a)(11), (a)(16), (a)(18), (a)(19), (a)(20), (a)(24), (a)(25), (a)(26), (a)(27), (a)(28), (a)(29), and (a)(30), and analogous records created pursuant to § 240.17a-3(e).

(2) * * *

(3) All bills receivable or payable (or copies thereof), paid or unpaid, relating to the business of such, broker or dealer, as such.

(4) Originals of all communications received and copies of all communications sent (and any approvals thereof) by the broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the broker or dealer is a member regarding communications with the public. As used in this paragraph (b)(4), the term communications includes sales scripts and recordings of telephone calls required to be maintained pursuant to section 15F(g)(1) of the Act (15 U.S.C. 78o-10(g)(1)).

(5) All trial balances, computations of aggregate indebtedness and net capital (and working papers in connection therewith), financial statements, branch office reconciliations, and internal audit working papers, relating to the business of such broker or dealer, as such.

(6) * * *

(7) All written agreements (or copies thereof) entered into by such broker or dealer relating to its business as such, including agreements with respect to any account. Written agreements with respect to a security-based swap customer or non-customer, including governing documents or any document establishing the terms and conditions of the customer's or non-customer's securities-based swaps must be maintained with the customer's or non-customer's account records.

(8) Records which contain the following information in support of amounts included in the report prepared as of the audit date on Form X-17A-5 (§ 249.617 of this chapter) Part II, or Part IIA or Part IIB, or Form SBS (§ 249.617 of this chapter), as applicable, and in the annual financial statements required by § 240.17a-5(d) and § 240.17a-12(b):

(i) Money balance and position, long or short, including description, quantity, price, and valuation of each security including contractual commitments in customers' accounts, in cash and fully secured accounts, partly secured accounts, unsecured accounts, and in securities accounts payable to customers;

* * * * *

(v) Description of futures commodity contracts or swaps, contract value on trade date, market value, gain or loss, and liquidating equity or deficit in customers' and non-customers' accounts;

(vi) Description of futures commodity contracts or swaps, contract value on trade date, market value, gain or loss, and liquidating equity or deficit in trading and investment accounts;

(vii) Description, money balance, quantity, price, and valuation of each spot commodity, and swap position or commitments in customers' and non-customers' accounts;

(viii) Description, money balance, quantity, price, and valuation of each spot commodity, and swap position or commitments in trading and investment accounts;

* * * * *

(xiii) Detail relating to information for possession or control requirements under § 240.15c3-3 and reported on the schedule in Part II or IIA of Form X-17A-5, or Form SBS (§ 249.617 of this chapter), as applicable;

(xiv) Detail relating to information for possession or control requirements under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] and reported on Form SBS (§ 249.617 of this chapter);

(xv) Detail of all items, not otherwise substantiated, which are charged or credited in the Computation of Net Capital pursuant to § 240.15c3-1, such as cash margin deficiencies, deductions related to securities values and undue concentration, aged securities differences, and insurance claims receivable;

(xvi) Detail relating to the calculation of the risk margin amount pursuant to § 240.15c3-1(c)(16); and

* * * * *

(14) A copy of information required to be reported under Regulation SBSR § 242.901 et seq. of this chapter;

(15) Copies of documents, communications, disclosures, and notices related to business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-6 and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011];

(16) Copies of documents used to make a reasonable determination with respect to special entities, including information relating to the financial status, the tax status, the

investment or financing objectives of the special entity as required under section 15F(h)(4)(C) and (5)(A) of the Act (15 U.S.C. 78o-10(h)(4)(C) and (5)(A)).

(c) Every broker or dealer subject to § 240.17a-3 must preserve for a period of not less than six years after the closing of any customer's account any account cards or records which relate to the terms and conditions with respect to the opening and maintenance of the account.

(d) Every broker or dealer subject to § 240.17a-3 must preserve during the life of the enterprise and of any successor enterprise all partnership articles or, in the case of a corporation, all articles of incorporation or charter, minute books, and stock certificate books (or, in the case of any other form of legal entity, all records such as articles of organization or formation, and minute books used for a purpose similar to those records required for corporations or partnerships), all Forms BD (§ 249.501 of this chapter), all Forms BDW (§ 249.501a of this chapter), all Forms SBSE-BD (§ 249.617 of this chapter), all Forms SBSE-W (§ 249.617 of this chapter), all amendments to these forms, all licenses or other documentation showing the registration of the broker or dealer with any securities regulatory authority.

(e) Every broker or dealer subject to § 240.17a-3 must maintain and preserve in an easily accessible place:

(1) All records required under § 240.17a-3(a)(12) until at least three years after the associated person's employment and any other connection with the broker or dealer has terminated.

(2) All records required under § 240.17a-3(a)(13) until at least three years after the termination of employment or association of those persons required by § 240.17f-2 to be fingerprinted.

(3) All records required pursuant to § 240.17a-3(a)(15) during the life of the enterprise.

(4) All records required pursuant to § 240.17a-3(a)(14) for three years.

* * * * *

(f) * * *

(3) If a broker or dealer uses micrographic media or electronic storage media, it must:

(vii) For every broker or dealer exclusively using electronic storage media for some or all of its record preservation under this section, at least one third party (the undersigned), who has access to and the ability to download information from the broker's or dealer's electronic storage media to any acceptable medium under this section, must file with the designated examining authority for the broker or dealer the following undertakings with respect to such records:

The undersigned hereby undertakes to furnish promptly to the U.S. Securities and Exchange Commission ("Commission"), its designees or representatives, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the broker or dealer, upon reasonable request, such information as deemed necessary by the staffs of the Commission, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the broker or dealer to download information kept on the broker's or dealer's electronic storage media to any medium acceptable under § 240.17a-4.

Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker's or dealer's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved by the broker or dealer pursuant to §§ 240.17a-3 and 17a-4 in a format acceptable to the staffs of the Commission, any self-regulatory organization of which it is a member, or any State securities regulator having

jurisdiction over the broker or dealer. Such arrangements will provide specifically that in the event of a failure on the part of a broker or dealer to download the record into a readable format and after reasonable notice to the broker or dealer, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, as the staffs of the Commission, any self-regulatory organization of which it is a member, or any State securities regulator having jurisdiction over the broker or dealer may request.

(g) If a person who has been subject to § 240.17a-3 ceases to transact a business in securities directly with others than members of a national securities exchange, or ceases to transact a business in securities through the medium of a member of a national securities exchange, or ceases to be registered pursuant to section 15 of the Act (15 U.S.C. 78o) such person must, for the remainder of the periods of time specified in this section, continue to preserve the records which it theretofore preserved pursuant to this section.

* * * * *

(m) * * *

- (1) The term office has the meaning set forth in § 240.17a-3(f)(1).
- (2) The term principal has the meaning set forth in § 240.17a-3(f)(2).
- (3) The term securities regulatory authority has the meaning set forth in § 240.17a-3(f)(3).
- (4) The term associated person has the meaning set forth in § 240.17a-3(f)(4).
- (5) The term business as such includes the business as a security-based swap dealer or major security-based swap participant with respect to a broker or dealer that is registered under

section 15F of the Act (15 U.S.C. 78o-10) as a security-based swap dealer or major security-based swap participant.

4. Section 240.17a-5 is amended by:
 - a. Revising the heading;
 - b. Adding an undesignated introductory paragraph;
 - c. Revising paragraph (a) introductory text and removing paragraph (a)(1);
 - d. Redesignating paragraphs (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7) as paragraphs (a)(1) (a)(2), (a)(3), (a)(4), (a)(5), and (a)(6), respectively;
 - e. Revising newly redesignated paragraphs (a)(1) introductory text, (a)(1)(ii), (a)(1)(iii), and (a)(1)(iv);
 - f. Adding paragraph (a)(1)(v);
 - g. In newly redesignated paragraphs (a)(2) and (a)(6), removing the word “shall” and adding in its place “will”;
 - h. Revising newly redesignated paragraphs (a)(3), (a)(4), and (a)(5);
 - i. Revising paragraph (b)(1);
 - j. In paragraphs (b)(3), (b)(4), and (b)(5), removing the word “shall” and adding in its place “will” wherever it appears;
 - k. In paragraphs (c)(1) introductory text, (c)(2), (c)(2)(i), and (c)(2)(ii) removing the word “shall” and adding in its place “must” wherever it appears;
 - l. Revising paragraph (c)(3);
 - m. In paragraph (c)(4)(iii), removing the word “shall” and adding in its place “must” where it appears;
 - n. In paragraph (c)(5)(i)(C), adding “(c)(2)” before “(iv)”;

- o. In paragraph (c)(5)(iii)(C), removing the word “Home” and adding in its place “home” wherever it appears;
- p. Revising paragraphs (d)(1)(i)(B)(1), (d)(1)(i)(B)(2), (d)(2)(i), (d)(2)(ii), (d)(2)(iii), (d)(3)(i)(A)(4), (d)(3)(i)(A)(5), (d)(3)(i)(C);
- q. In paragraph (d)(3)(ii), adding the phrase “§ 240.18a-4,” after the phrase “§ 240.17a-13,”;
- r. Revising paragraphs (d)(3)(iii), (e)(1)(ii), (e)(2), and (e)(3);
- s. Revising paragraphs (f)(2)(ii)(E) and (f)(2)(ii)(F);
- t. In the fifth sentence of paragraph (f)(3)(v)(B), adding the word “the” before the phrase “independent public accountant does not agree”;
- u. Revising paragraphs (g)(2)(i), (g)(2)(ii), (h), and note to paragraph (h);
- v. Revising paragraphs (i)(3)(iii)(A) and (i)(3)(iii)(B), and (i)(4);
- w. Revising paragraph (j);
- x. In paragraph (k) introductory text, removing the word “shall” and adding in its place “must” wherever it appears, and removing the phrase “Market Regulation”, and adding in its place “Trading and Markets”;
- y. In paragraph (l), removing the phrase “Securities Exchange Act of 1934”, and adding in its place “Act,” and removing the word “shall” and adding in its place “must”;
- z. In paragraph (m)(1), removing the word “shall” and adding in its place “must”;
- aa. In paragraph (m)(2), removing “(48 Stat. 882; 15 U.S.C. 78c)” and “(78 Stat. 565; 15 U.S.C. 78c)” and adding in their place “(15 U.S.C. 78c)” and “(15 U.S.C. 78c)”, respectively;
- bb. In paragraph (m)(4), removing the phrase “shall” and adding in its place “will”;

cc. In paragraph (n)(2), removing the word “shall” and adding in its place “must”;
and

dd. Revising paragraph (o).

The additions and revisions read as follows:

§ 240.17a-5 Reports to be made by certain brokers and dealers.

Section 240.17a-5 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o-8(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the reporting requirements under § 240.18a-7.

(a) Monthly and Quarterly Reports.

(1) Filing of Reports

(i) * * *

(ii) Every broker or dealer subject to this paragraph (a) who clears transactions or carries customer accounts and that is not registered as a security-based swap dealer or major security-based swap participant under section 15F of the Act (15 U.S.C. 78o-10) must file with the Commission an executed Part II of Form X-17A-5 (§ 249.617 of this chapter) within 17 business days after the end of the calendar quarter and within 17 business days after the end of the fiscal year of the broker or dealer where that date is not the end of a calendar quarter. Certain of such brokers or dealers must file with the Commission an executed Part IIA in lieu thereof if the nature of their business is limited as described in the instructions to Part II of Form X-17A-5 (§ 249.617 of this chapter).

(iii) Every broker or dealer that neither clears transactions nor carries customer accounts and that is not registered as a security-based swap dealer or major security-based swap participant under section 15F of the Act (15 U.S.C. 78o-10) must file with the Commission an executed Part IIA of Form X-17A-5 (§ 249.617 of this chapter) within 17 business days after the end of each calendar quarter and within 17 business days after the end of the fiscal year of the broker or dealer where that date is not the end of a calendar quarter.

(iv) Every broker or dealer that is registered as a security-based swap dealer or major security-based swap participant under section 15F of the Act (15 U.S.C. 78o-10) must file with the Commission an executed Form SBS (§ 249.617 of this chapter) within 17 business days after the end of each month.

(v) Upon receiving written notice from the Commission or the examining authority designated pursuant to section 17(d) of the Act (15 U.S.C. 78q(d)) ("designated examining authority"), a broker or dealer who receives such notice must file with the Commission on a monthly basis, or at such times as will be specified, an executed Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter), or an executed Form SBS (§ 249.617 of this chapter), and such other financial or operational information as will be required by the Commission or the designated examining authority.

(2) The reports provided for in this paragraph (a) that must be filed with the Commission will be considered filed when received at the Commission's principal office in Washington, DC, and the regional office of the Commission for the region in which the broker or dealer has its principal place of business. All reports filed pursuant to this paragraph (a) will be deemed to be confidential.

(3) The provisions of paragraph (a)(1) of this section will not apply to a member of a national securities exchange or a registered national securities association if said exchange or association maintains records containing the information required by Part I, Part II, or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) or Form SBS (§ 249.617 of this chapter), as to such member, and transmits to the Commission a copy of the applicable parts of Form X-17A-5 (§ 249.617 of this chapter) or Form SBS (§ 249.617 of this chapter) as to such member, pursuant to a plan, the procedures and provisions of which have been submitted to and declared effective by the Commission. Any such plan filed by a national securities exchange or a registered national securities association may provide that when a member is also a member of one or more national securities exchanges, or of one or more national securities exchanges and a registered national securities association, the information required to be submitted with respect to any such member may be submitted by only one specified national securities exchange or registered national securities association. For the purposes of this section, a plan filed with the Commission by a national securities exchange or a registered national securities association will not become effective unless the Commission, having due regard for the fulfillment of the Commission's duties and responsibilities under the provisions of the Act, declares the plan to be effective. Further, the Commission, in declaring any such plan effective, may impose such terms and conditions relating to the provisions of the plan and the period of its effectiveness as may be deemed necessary or appropriate in the public interest, for the protection of investors, or to carry out the Commission's duties and responsibilities under the Act.

(4) Every broker or dealer subject to this paragraph (a) must file Form Custody (§ 249.639 of this chapter) with its designated examining authority within 17 business days after the end of each calendar quarter and within 17 business days after the end of the fiscal year of

the broker or dealer where that date is not the end of a calendar quarter. The designated examining authority must maintain the information obtained through the filing of Form Custody and must promptly transmit that information to the Commission at such time as it transmits the applicable part of Form X-17A-5 (§ 249.617 of this chapter), or Form SBS (§ 249.617 of this chapter) as required in paragraph (a)(2) of this section.

(5) Each broker or dealer that computes certain of its capital charges in accordance with § 240.15c3-1e must file the following additional reports with the Commission:

(i) For each product for which the broker or dealer calculates a deduction for market risk other than in accordance with § 240.15c3-1e(b)(1) or (b)(3), the product category and the amount of the deduction for market risk within 17 business days after the end of the month;

(ii) A graph reflecting, for each business line, the daily intra-month VaR within 17 business days after the end of the month;

(iii) The aggregate value at risk for the broker or dealer within 17 business days after the end of the month;

(iv) For each product for which the broker or dealer uses scenario analysis, the product category and the deduction for market risk within 17 business days after the end of the month;

(v) Credit risk information on derivatives exposures within 17 business days after the end of the month, including:

(A) Overall current exposure;

(B) Current exposure (including commitments) listed by counterparty for the 15 largest exposures;

(C) The ten largest commitments listed by counterparty;

(D) The broker's or dealer's maximum potential exposure listed by counterparty for the 15 largest exposures;

(E) The broker's or dealer's aggregate maximum potential exposure;

(F) A summary report reflecting the broker's or dealer's current and maximum potential exposures by credit rating category; and

(G) A summary report reflecting the broker's or dealer's current exposure for each of the top ten countries to which the broker or dealer is exposed (by residence of the main operating group of the counterparty);

(vi) Regular risk reports supplied to the broker's or dealer's senior management in the format described in the application;

(vii) The results of the liquidity stress test required by § 240.15c3-1(f) within 17 business days after the end of the month;

(viii) A report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR within 17 business days after the end of each calendar quarter; and

(ix) The results of backtesting of all internal models used to compute allowable capital, including VaR and credit risk models, indicating the number of backtesting exceptions within 17 business days after the end of the calendar quarter.

(6) * * *

(b) * * *

(1) If a broker or dealer holding any membership interest in a national securities exchange or registered national securities association ceases to be a member in good standing of such exchange or association, such broker or dealer must, within two business days after such

event, file with the Commission Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) or Form SBS (§ 249.617 of this chapter) as determined by the standards set forth in paragraphs (a)(1) (ii), (iii), and (iv) of this section as of the date of such event. The report must be filed at the Commission's principal office in Washington, DC, and with the regional office of the Commission for the region in which the broker or dealer has its principal place of business: Provided, however, That such report need not be made or filed if the Commission, upon written request or upon its own motion, exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement: Provided, further, That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

* * * * *

(c) * * *

(3) Unaudited statements to be furnished. Unaudited statements dated 6 months from the date of the audited statements required to be furnished by paragraphs (c)(1) and (c)(2) of this section must be furnished within 65 days after the date of the unaudited statements. The unaudited statements may be furnished 70 days after that time limit has expired if the broker or dealer sends them with the next mailing of the broker's or dealer's quarterly customer statements of account. In that case, the broker or dealer must include a statement in that mailing of the amount of the broker's or dealer's net capital and its required net capital in accordance with § 240.15c3-1, as of a fiscal month end that is within the 75-day period immediately preceding the date the statements are sent to customers. The unaudited statements must contain the information specified in paragraphs (c)(2)(i) and (c)(2)(ii) of this section.

* * * * *

(d) * * *

(1) * * *

(i) * * *

(B)(1) If the broker or dealer did not claim it was exempt from § 240.15c3-3 throughout the most recent fiscal year or the broker or dealer is subject to § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], a compliance report as described in paragraph (d)(3) of this section executed by the person who makes the oath or affirmation under paragraph (e)(2) of this section; or

(2) If the broker or dealer did claim it was exempt from § 240.15c3-3 throughout the most recent fiscal year and the broker or dealer is not subject § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], an exemption report as described in paragraph (d)(4) of this section executed by the person who makes the oath or affirmation under paragraph (e)(2) of this section;

* * * * *

(2) * * *

(i) A Statement of Financial Condition, a Statement of Income, a Statement of Cash Flows, a Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and a Statement of Changes in Liabilities Subordinated to Claims of General Creditors. The statements must be prepared in accordance with U.S. generally accepted accounting principles and must be in a format that is consistent with the statements contained in Form X-17A-5 (§ 249.617 of this chapter) Part II, Part IIA or Form SBS (§ 249.617 of this chapter), as applicable. If the Statement of Financial Condition filed in accordance with instructions to Form X-17A-5, Part II, Part IIA, or Form SBS, as applicable, is not consolidated, a summary of financial data, including the

assets, liabilities, and net worth or stockholders' equity, for subsidiaries not consolidated in the applicable Part II, Part IIA, or Form SBS Statement of Financial Condition as filed by the broker or dealer must be included in the notes to the financial statements reported on by the independent public accountant.

(ii) Supporting schedules that include, from Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter), or Form SBS (§ 249.617 of this chapter), as applicable, including a Computation of Net Capital under § 240.15c3-1, a Computation for Determination of the Reserve Requirements under Exhibit A of § 240.15c3-3, and, if applicable, under Exhibit A of § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], and Information Relating to the Possession or Control Requirements under § 240.15c3-3, and, if applicable, under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012].

(iii) If either the Computation of Net Capital under § 240.15c3-1 or the Computation for Determination of the Reserve Requirements Under Exhibit A of § 240.15c3-3, or, if applicable Exhibit A of § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] in the financial report is materially different from the corresponding computation in the most recent Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) or Form SBS (§ 249.617 of this chapter), as applicable, filed by the broker or dealer pursuant to paragraph (a) of this section, a reconciliation, including appropriate explanations, between the computation in the financial report and the computation in the most recent Part II or Part IIA of Form X-17A-5 or Form SBS (§ 249.617 of this chapter), as applicable, filed by the broker or dealer. If no material differences exist, a statement so indicating must be included in the financial report.

* * * * *

(3) * * *

(i) * * *

(A) * * *

(4) The broker or dealer was in compliance with §§ 240.15c3-1, 240.15c3-3(e) and, if applicable, 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] as of the end of the most recent fiscal year; and

(5) The information the broker or dealer used to state whether it was in compliance with §§ 240.15c3-1, 240.15c3-3(e) and, if applicable, 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] was derived from the books and records of the broker or dealer.

(B) * * *

(C) If applicable, a description of an instance of non-compliance with §§ 240.15c3-1, 240.15c3-3(e) or, if applicable, 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] as of the end of the most recent fiscal year.

(ii) * * *

(iii) The broker or dealer is not permitted to conclude that its Internal Control Over Compliance was effective during the most recent fiscal year if there were one or more material weaknesses in its Internal Control Over Compliance during the most recent fiscal year. The broker or dealer is not permitted to conclude that its Internal Control Over Compliance was effective as of the end of the most recent fiscal year if there were one or more material weaknesses in its internal control as of the end of the most recent fiscal year. A material weakness is a deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with §§ 240.15c3-1, 240.15c3-3(e) or 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] will not be prevented or detected on a timely basis or that non-compliance to a material extent with §

240.15c3-3, except for paragraph (e), § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], except for paragraph (c), § 240.17a-13 or any Account Statement Rule will not be prevented or detected on a timely basis. A deficiency in Internal Control Over Compliance exists when the design or operation of a control does not allow the management or employees of the broker or dealer, in the normal course of performing their assigned functions, to prevent or detect on a timely basis non-compliance with § 240.15c3-1, § 240.15c3-3, § 240.17a-13, § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], or any Account Statement Rule.

* * * * *

(e) * * *

(1) * * *

(ii) A broker or dealer that files an annual report under paragraph (d) of this section that is not covered by a report prepared by an independent public accountant must include in the oath or affirmation required by paragraph (e)(2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the requirement that the annual report filed under paragraph (d) of this section be covered by reports prepared by an independent public accountant.

(2) The broker or dealer must attach to each of the confidential and non-confidential portions of the annual reports separately bound under paragraph (e)(3) of this section a complete and executed Part III of Form X-17A-5 (§ 249.617 of this chapter). The oath or affirmation made in Part III of Form X-17A-5 must be made before a person duly authorized to administer such oaths or affirmations. If the broker or dealer is a sole proprietorship, the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; if a corporation, by a duly authorized officer; or if a limited liability company or limited liability partnership, by the chief

executive officer, chief financial officer, manager, managing member, or those members vested with management authority for the limited liability company or limited liability partnership.

(3) The annual reports filed under paragraph (d) of this section are not confidential, except that, if the Statement of Financial Condition in a format that is consistent with Form X-17A-5 (§ 249.617 of this chapter), Part II, Part IIA or Form SBS (§ 249.617 of this chapter) is bound separately from the balance of the annual reports filed under paragraph (d) of this section, and each page of the balance of the annual reports is stamped "confidential," then the balance of the annual reports will be deemed confidential to the extent permitted by law. However, the annual reports, including the confidential portions, will be available for official use by any official or employee of the U. S. or any State, by national securities exchanges and registered national securities associations of which the broker or dealer filing such a report is a member, by the Public Company Accounting Oversight Board, and by any other person if the Commission authorizes disclosure of the annual reports to that person as being in the public interest. Nothing contained in this paragraph may be construed to be in derogation of the rules of any registered national securities association or national securities exchange that give to customers of a broker or dealer the right, upon request to the broker or dealer, to obtain information relative to its financial condition.

* * * * *

(f) * * *

(2) * * *

(ii) * * *

(E) A representation that the independent public accountant has undertaken the items enumerated in paragraphs (g)(1) and (2) of this section.

(F) Except as provided in paragraph (f)(2)(iii) of this section, a representation that the broker or dealer agrees to allow representatives of the Commission or its designated examining authority, if requested in writing for purposes of an examination of the broker or dealer, to review the audit documentation associated with the reports of the independent public accountant filed under paragraph (d)(1)(i)(C) of this section. For purposes of this paragraph, "audit documentation" has the meaning provided in standards of the Public Company Accounting Oversight Board. The Commission anticipates that, if requested, it will accord confidential treatment to all documents it may obtain from an independent public accountant under this paragraph to the extent permitted by law.

* * * * *

(g) * * *

(2)(i) To prepare an independent public accountant's report based on an examination of the statements required under paragraphs (d)(3)(i)(A)(2) through (5) of this section in the compliance report required to be filed by the broker or dealer under paragraph (d)(1)(i)(B)(1) of this section in accordance with standards of the Public Company Accounting Oversight Board; or

(ii) To prepare an independent public accountant's report based on a review of the statements required under paragraphs (d)(4)(i) through (iii) of this section in the exemption report required to be filed by the broker or dealer under paragraph (d)(1)(i)(B)(2) of this section, in accordance with standards of the Public Company Accounting Oversight Board.

(h) Notification of non-compliance or material weakness. If, during the course of preparing the independent public accountant's reports required under paragraph (d)(1)(i)(C) of this section, the independent public accountant determines that the broker or dealer is not in

compliance with § 240.15c3-1, § 240.15c3-3, § 240.17a-13, or § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] or any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer, as applicable, or the independent public accountant determines that any material weaknesses (as defined in paragraph (d)(3)(iii) of this section) exist, the independent public accountant must immediately notify the chief financial officer of the broker or dealer of the nature of the non-compliance or material weakness. If the notice from the accountant concerns an instance of non-compliance that would require a broker or dealer to provide a notification under § 240.15c3-1, § 240.15c3-3, or § 240.17a-11, or if the notice concerns a material weakness, the broker or dealer must provide a notification in accordance with § 240.15c3-1, § 240.15c3-3, or § 240.17a-11, as applicable, and provide a copy of the notification to the independent public accountant. If the independent public accountant does not receive the notification within one business day, or if the independent public accountant does not agree with the statements in the notification, then the independent public accountant must notify the Commission and the designated examining authority within one business day. The report from the accountant must, if the broker or dealer failed to file a notification, describe any instances of non-compliance that required a notification under §§ 240.15c3-1, 240.15c3-3, or 240.17a-11, or any material weaknesses. If the broker or dealer filed a notification, the report from the accountant must detail the aspects of the notification of the broker or dealer with which the accountant does not agree.

Note to paragraph (h). The attention of the broker or dealer and the independent public accountant is called to the fact that under § 240.17a-11(a)(1), among other things, a broker or dealer whose net capital declines below the minimum required pursuant to § 240.15c3-1 must give notice of such deficiency that same day in accordance with § 240.17a-11(h) and the notice

must specify the broker or dealer's net capital requirement and its current amount of net capital.

The attention of the broker or dealer and accountant also is called to the fact that under § 240.15c3-3(i), if a broker or dealer shall fail to make a reserve bank account or special account deposit, as required by § 240.15c3-3, the broker or dealer must immediately notify the Commission and the regulatory authority for the broker or dealer, which examines such broker or dealer as to financial responsibility and must promptly thereafter confirm such notification in writing.

* * * * *

(i) * * *

(3) * * *

(iii)(A) The opinion of the independent public accountant with respect to the statements required under paragraphs (d)(3)(i)(A)(2) through (5) of this section in the compliance report required under paragraph (d)(1)(i)(B)(1) of this section; or

(B) The conclusion of the independent public accountant with respect to the statements required under paragraphs (d)(4)(i) through (iii) of this section in the exemption report required under paragraph (d)(1)(i)(B)(2) of this section.

(4) Exceptions. Any matters to which the independent public accountant takes exception must be clearly identified, the exceptions must be specifically and clearly stated, and, to the extent practicable, the effect of each such exception on any related items contained in the annual reports required under paragraph (d) of this section must be given.

* * * * *

(o) Filing requirements. For purposes of filing requirements as described in this section, filing will be deemed to have been accomplished upon receipt at the Commission's principal

office in Washington, DC, with duplicate originals simultaneously filed at the locations prescribed in the particular paragraph of this section which is applicable.

* * * * *

5. Section 240.17a-11 is amended by:
 - a. Revising the heading;
 - b. Adding an undesignated introductory paragraph;
 - c. Removing paragraph (a);
 - d. Redesignating paragraphs (b), (c), (d), (e), (f), (g), (h), and (i) as paragraphs (a), (b), (c), (d), (g), (h), (i), and (j), respectively;
 - e. Revising newly redesignated paragraphs (a)(1), (a)(2), and paragraph (b) introductory text;
 - f. Adding paragraph (b)(6);
 - g. Revising newly redesignated paragraphs (c) and (d);
 - h. Adding paragraphs (e) and (f); and
 - i. Revising newly redesignated paragraphs (g), (h), (i), and (j).

The revisions and additions read as follows:

§ 240.17a-11 Notification provisions for brokers and dealers.

Section 240.17a-11 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o-8(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the notification requirements under § 240.18a-8.

(a)(1) Every broker or dealer whose net capital declines below the minimum amount required pursuant to § 240.15c3-1, or is insolvent as that term is defined in § 240.15c3-1(c)(16), must give notice of such deficiency that same day in accordance with paragraph (h) of this section. The notice must specify the broker or dealer's net capital requirement and its current amount of net capital. If a broker or dealer is informed by its designated examining authority or the Commission that it is, or has been, in violation of § 240.15c3-1 and the broker or dealer has not given notice of the capital deficiency under this section, the broker or dealer, even if it does not agree that it is, or has been, in violation of § 240.15c3-1, must give notice of the claimed deficiency, which notice may specify the broker's or dealer's reasons for its disagreement.

(2) In addition to the requirements of paragraph (b)(1) of this section, an OTC derivatives dealer or broker or dealer permitted to compute net capital pursuant to the alternative method of § 240.15c3-1e must also provide notice if its tentative net capital falls below the minimum amount required pursuant to § 240.15c3-1. The notice must specify the dealer's tentative net capital requirements, and current amount of net capital and tentative net capital, of the OTC derivatives dealer or the broker or dealer permitted to compute net capital pursuant to the alternative method of § 240.15c3-1e.

(b) Every broker or dealer must send notice promptly (but within 24 hours) after the occurrence of the events specified in paragraph (b)(1), (b)(2), (b)(3) or (b)(4) of this section in accordance with paragraph (h) of this section:

* * * * *

(6) If the broker or dealer is registered as a major security-based swap participant and the level of tangible net worth of the broker or dealer falls below \$20 million.

(c) Every broker or dealer that fails to make and keep current the books and records required by § 240.17a-3, must give notice of this fact that same day in accordance with paragraph (h) of this section, specifying the books and records which have not been made or which are not current. The broker or dealer must also transmit a report in accordance with paragraph (h) of this section within 48 hours of the notice stating what the broker or dealer has done or is doing to correct the situation.

(d) Whenever any broker or dealer discovers, or is notified by an independent public accountant under § 240.17a-12(i)(2), of the existence of any material inadequacy as defined in § 240.17a-12(h)(2), or whenever any broker or dealer discovers, or is notified by an independent public accountant under § 240.17a-5(h), of the existence of any material weakness as defined in § 240.17a-5(d)(3)(iii), the broker or dealer must:

(1) Give notice, in accordance with paragraph (h) of this section, of the material inadequacy or material weakness within 24 hours of the discovery or notification of the material inadequacy or material weakness; and

(2) Transmit a report in accordance with paragraph (h) of this section, within 48 hours of the notice stating what the broker or dealer has done or is doing to correct the situation.

(e) A broker or dealer that has been authorized by the Commission to compute net capital pursuant to § 240.15c3-1e must give immediate notice in writing in accordance with paragraph (h) of this section if a liquidity stress test conducted pursuant to § 240.15c3-1(f) indicates that the amount of liquidity reserve is insufficient.

(f) If a broker-dealer registered with the Commission as a security-based swap dealer under section 15F(b) of the Act (15 U.S.C. 78o-10(b)) fails to make in its special account for the exclusive benefit of security-based swap customers a deposit, as required by § 240.18a-4(c) [as

proposed at 77 FR 70214, Nov. 23, 2012], the broker-dealer must give immediate notice in writing in accordance with paragraph (h) of this section.

(g) Every national securities exchange or national securities association that learns that a broker or dealer has failed to send notice or transmit a report as required by this section, even after being advised by the securities exchange or the national securities association to send notice or transmit a report, must immediately give notice of such failure in accordance with paragraph (h) of this section.

(h) Every notice or report required to be given or transmitted by this section must be given or transmitted to the principal office of the Commission in Washington, DC, the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the designated examining authority of which such broker or dealer is a member, and the Commodity Futures Trading Commission if the broker or dealer is registered as a futures commission merchant with such Commission. For the purposes of this section, "notice" must be given or transmitted by facsimile transmission. The report required by paragraphs (c) or (d)(2) of this section may be transmitted by overnight delivery.

(i) Other notice provisions relating to the Commission's financial responsibility or reporting rules are contained in § 240.15c3-1, § 240.15c3-1d, § 240.15c3-3, § 240.17a-5, and § 240.17a-12.

(j) The provisions of this section will not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78o(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to section 15A(a) of the Act (15 U.S.C. 78o-3(a)).

* * * * *

6. Section 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] is revised by adding paragraph (c)(1)(x) to read as follows:

§ 240.18a-1 Net capital requirements for security-based swap dealers for which there is not a prudential regulator.

* * * * *

(c) * * *

(1) * * *

(x)(A) Deducting the market value of all short securities differences (which shall include securities positions reflected on the securities record which are not susceptible to either count or confirmation) unresolved after discovery in accordance with the following schedule:

Differences ¹	Number of business days after discovery
25 percent	7
50 percent	14
75 percent	21
100 percent	28

¹ Percentage of market value of short securities differences.

(B) Deducting the market value of any long securities differences, where such securities have been sold by the broker or dealer before they are adequately resolved, less any reserves established therefor;

(C) The designated examining authority for a broker or dealer may extend the periods in (x)(A) of this section for up to 10 business days if it finds that exceptional circumstances warrant an extension.

* * * * *

7. Sections 240.18a-5 through 240.18a-9 are added to read as follows:

§ 240.18a-5 Records to be made by certain security-based swap dealers and major security-based swap participants.

Section 240.18a-5 applies to a security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act (15 U.S.C. 78o-8(b)) that is not also registered as a broker or dealer under section 15(b) of the Act (15 U.S.C. 78o(b)). A broker or dealer registered under section 15(b) of the Act, including a broker or dealer registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act, is subject to the books and records requirements under § 240.17a-3.

(a) This paragraph applies only to security-based swap dealers and major security-based swap participants registered under section 15F of the Act (15 U.S.C. 78o-10) for which there is no prudential regulator. Each such security-based swap dealer and major security-based swap participant subject to this paragraph must make and keep the following books and records:

(1) Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities (including security-based swaps), all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records must show the account for which each such purchase or sale was effected, the name and amount of securities, the unit and aggregate purchase or sale price, if any, the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered. For security-based swaps, such records must also show, for each purchase or sale, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(2) Ledgers (or other records) reflecting all assets and liabilities, income and expense, and capital accounts.

(3) Ledger accounts (or other records) itemizing separately as to each account for every customer or non-customer of such security-based swap dealer or major security-based swap participant, all purchases and sales, receipts and deliveries of securities and commodities for such account and all other debits and credits to such account, and in addition, in the case of security-based swaps, ledger accounts (or other records) itemizing separately, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(4) A securities record or ledger reflecting separately for each:

(i) Security, other than a security-based swap, as of the clearance dates all "long" or "short" positions (including securities in safekeeping and securities that are the subject of repurchase or reverse repurchase agreements) carried by such security-based swap dealer or major security-based swap participant for its account or the account of its customers and showing the locations of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and, in all cases, the name or designation of the account in which each position is carried.

(ii) Security-based swap, the reference security, index, or obligor, the unique transaction identifier, the unique counterparty identifier, whether it is a "long" or "short" position in the security-based swap, whether the security-based swap is cleared or not cleared, and if cleared, identification of the clearing agency where the security-based swap is cleared.

(5) A memorandum of each purchase or sale of a security-based swap for the account of the security-based swap dealer or major security-based swap participant showing the price. The memorandum must also include the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier. An order entered pursuant to the exercise of discretionary authority must be so designated.

(6) With respect to a security other than a security-based swap, copies of confirmations of all purchases and sales of securities. With respect to a security-based swap, copies of the security-based swap trade acknowledgement and verification made in compliance with § 240.15Fi-1 [as proposed at 76 FR 3859, Jan. 21, 2011].

(7) For each security-based swap account, a record of the unique counterparty identifier, the name and address of such counterparty, and the signature of each person authorized to transact business in the security-based swap account.

(8) A record of all puts, calls, spreads, straddles and other options in which such security-based swap dealer or major security-based swap participant has any direct or indirect interest or which such security-based swap dealer or major security-based swap participant has granted or guaranteed, containing, at least, an identification of the security, and the number of units involved.

(9) A record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of net capital or tangible net worth, as applicable, as of the trial balance date, pursuant to § 240.18a-1 or § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], respectively. Such trial balances and computations must be prepared currently at least once per month.

(10)(i) A questionnaire or application for employment executed by each "associated person" (as defined in paragraph (c) of this section) of the security-based swap dealer or major security-based swap participant which questionnaire or application must be approved in writing by an authorized representative of the security-based swap dealer or major security-based swap participant and must contain at least the following information with respect to the associated person:

(A) The associated person's name, address, social security number, and the starting date of the associated person's employment or other association with the security-based swap dealer or major security-based swap participant;

(B) The associated person's date of birth;

(C) A complete, consecutive statement of all the associated person's business connections for at least the preceding ten years, including whether the employment was part-time or full-time;

(D) A record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, or by any national securities exchange or national securities association, including any finding that the associated person was a cause of any disciplinary action or had violated any law;

(E) A record of any denial, suspension, expulsion or revocation of membership or registration of any broker, dealer, security-based swap dealer or major security-based swap participant with which the associated person was associated in any capacity at the time such action was taken;

(F) A record of any permanent or temporary injunction entered against the associated person, or any broker, dealer, security-based swap dealer or major security-based swap

participant with which the associated person was associated in any capacity at the time such injunction was entered;

(G) A record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities, commodities, banking, insurance or real estate (including, but not limited to, acting or being associated with a broker or dealer, security-based swap dealer, major security-based swap participant, investment company, investment adviser, futures sponsor, bank, or savings and loan association), fraud, false statements or omissions, wrongful taking of property or bribery, forgery, counterfeiting or extortion, and the disposition of the foregoing; and

(H) A record of any other name or names by which the associated person has been known or which the associated person has used.

(ii) A record listing every associated person of the security-based swap dealer, major security-based swap participant which shows, for each associated person, every office of the security-based swap dealer or major security-based swap participant where the associated person regularly conducts the business of handling funds or securities or effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, for the security-based swap dealer or major security-based swap participant and the Central Registration Depository number, if any, and every internal identification number or code assigned to that person by the security-based swap dealer or major security-based swap participant.

(11) A report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under § 240.18a-1(f) [as proposed at 77 FR 70214, Nov. 23, 2012], if applicable.

(12) A record of the daily calculation of the amount of equity and, if applicable, the margin amount for each account of a counterparty required under § 240.18a-3(c) [as proposed at 77 FR 70214, Nov. 23, 2012].

(13) A record of compliance with possession or control requirements under § 240.18a-4(b) [as proposed at 77 FR 70214, Nov. 23, 2012].

(14) A record of the reserve computation required under § 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012].

(15) A record of each security-based swap transaction that is not verified under § 240.15Fi-1 [as proposed at 76 FR 3859, Jan. 21, 2011] within five business days of execution that includes, at a minimum, the unique transaction identifier and unique counterparty identifier.

(16) A record that demonstrates the security-based swap dealer or major security-based swap participant has complied with the business conduct standards as required under § 240.15Fh-6 [as proposed at 76 FR 42396, July 18, 2011].

(17) A record that demonstrates the security-based swap dealer or major security-based swap participant has complied with the business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-5, and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011].

(b) This paragraph applies only to security-based swap dealers and major security-based swap participants registered under section 15F of the Act (15 U.S.C. 78o-10) for which there is a prudential regulator. Each security-based swap dealer and major security-based swap participant subject to this paragraph must make and keep the following books and records:

(1) For security-based swaps and any other positions related to the firm's business as a security-based swap dealer or a major security-based swap participant, blotters (or other records

of original entry) containing an itemized daily record of all purchases and sales of securities (including security-based swaps), all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records must show, the account for which each such purchase and sale was effected, the name and amount of securities, the unit and aggregate purchase or sale price, if any (includes the contract price for security-based swaps), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered. For security-based swaps, such records must also show, for each purchase and sale, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(2) Ledger accounts (or other records) itemizing separately as to each account for every security-based swap customer or non-customer and of such security-based swap dealer or major security-based swap participant, all purchases, sales, receipts and deliveries of securities and commodities for such account and all other debits and credits to such account, and in addition, for security-based swaps, the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier.

(3) For security-based swaps and any securities positions related to the firm's business as a security-based swap dealer or a major security-based swap participant, a securities record or ledger reflecting separately for each:

(i) Security, other than a security-based swap, as of the clearance dates all "long" or "short" positions (including securities in safekeeping and securities that are the subjects of

repurchase or reverse repurchase agreements) carried by such security-based swap dealer or major security-based swap participant for its account or for the account of its customers and showing the location of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried.

(ii) Security-based swap, the reference security, index, or obligor, the unique transaction identifier, the unique counterparty identifier, whether it is a "long" or "short" position in the security-based swap, whether the security-based swap is cleared or not cleared, and if cleared, identification of the clearing agency where the security-based swap is cleared.

(4) A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security-based swap, whether executed or unexecuted. The memorandum must show the terms and conditions of the order or instructions and of any modification or cancellation thereof; the account for which entered; the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer, or, if a customer entered the order on an electronic system, a notation of that entry; and, to the extent feasible, the time of cancellation, if applicable. The memorandum also must include the type of the security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier. An order entered pursuant to the exercise of discretionary authority must be so designated.

(5) A memorandum of each purchase or sale of a security-based swap for the account of the security-based swap dealer or major security-based swap participant showing the price. The memorandum must also include the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the termination or maturity date, the notional amount, the unique transaction identifier, and the unique counterparty identifier. An order entered pursuant to the exercise of discretionary authority must be so designated.

(6) With respect to a security other than a security-based swap, copies of confirmations of all purchases and sales of securities related to the business of a security-based swap dealer or major security-based swap participant. With respect to a security-based swap, copies of the security-based swap trade acknowledgement and verification made in compliance with § 240.15Fi-1 [as proposed at 76 FR 3859, Jan. 21, 2011].

(7) For each security-based swap account, a record of the unique counterparty identifier, the name and address of such counterparty, and the signature of each person authorized to transact business in the security-based swap account.

(8)(i) A questionnaire or application for employment executed by each "associated person" (as defined in paragraph (c) of this section) of the security-based swap dealer or major security-based swap participant whose activities relate to the business of the security-based swap dealer or major security-based swap participant, which questionnaire or application must be approved in writing by an authorized representative of the security-based swap dealer or major security-based swap participant and must contain at least the following information with respect to the associated person:

(A) The associated person's name, address, social security number, and the starting date of the associated person's employment or other association with the security-based swap dealer or major security-based swap participant;

(B) The associated person's date of birth;

(C) A complete, consecutive statement of all the associated person's business connections for at least the preceding ten years, including whether the employment was part-time or full-time;

(D) A record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, or by any national securities exchange or national securities association, including any finding that the associated person was a cause of any disciplinary action or had violated any law;

(E) A record of any denial, suspension, expulsion or revocation of membership or registration of any broker, dealer, security-based swap dealer or major security-based swap participant with which the associated person was associated in any capacity at the time such action was taken;

(F) A record of any permanent or temporary injunction entered against the associated person, or any broker, dealer, security-based swap dealer or major security-based swap participant with which the associated person was associated in any capacity at the time such injunction was entered;

(G) A record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities, commodities, banking, insurance or real estate (including, but not limited to, acting or being associated with a broker or dealer, security-based swap dealer, major security-based swap participant, investment company, investment adviser, futures sponsor, bank, or savings and

loan association), fraud, false statements or omissions, wrongful taking of property or bribery, forgery, counterfeiting or extortion, and the disposition of the foregoing; and

(H) A record of any other name or names by which the associated person has been known or which the associated person has used.

(ii) A record listing every associated person of the security-based swap dealer, major security-based swap participant which shows, for each associated person, every office of the security-based swap dealer or major security-based swap participant where the associated person regularly conducts the business of handling funds or securities or effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, for the security-based swap dealer or major security-based swap participant and every internal identification number or code assigned to that person by the security-based swap dealer or major security-based swap participant.

(9) A record of compliance with possession or control requirements under § 240.18a-4(b) [as proposed at 77 FR 70214, Nov. 23, 2012].

(10) A record of the reserve computation required under § 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012].

(11) A record of each security-based swap transaction that is not verified under § 240.15Fi-1 [as proposed at 76 FR 3859, Jan. 21, 2011] within five business days of execution that includes, at a minimum, the unique transaction identifier and unique counterparty identifier.

(12) A record that demonstrates the security-based swap dealer or major security-based swap participant has complied with the business conduct standards as required under § 240.15Fh-6 [as proposed at 76 FR 42396, July 18, 2011].

(13) A record that demonstrates the security-based swap dealer or major security-based swap participant has complied with the business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-5 and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011].

(c)(1) The term associated person means for purposes of this section a “person associated with a security-based swap dealer or major security-based swap participant” as defined under section 3(a)(70) of the Act.

(2) The term, as to a person supervised by a prudential regulator, includes only those persons whose activities relate to its business as a security-based swap dealer or major security-based swap participant.

§ 240.18a-6 Records to be preserved by certain security-based swap dealers and major security-based swap participants.

Section 240.18a-6 applies to a security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act (15 U.S.C. 78o-10(b)) that is not also registered as a broker or dealer under section 15(b) of the Act (15 U.S.C. 78o(b)). A broker or dealer registered under section 15(b) of the Act, including a broker or dealer registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act, is subject to the record maintenance and preservation requirements under § 240.17a-4.

(a)(1) Every security-based swap dealer or major security-based swap participant subject to § 240.18a-5(a) must preserve for a period not less than six years, the first two years in an easily accessible place, all records required to be made pursuant to paragraphs § 240.18a-5(a)(1), (a)(2), (a)(3), and (a)(4).

(2) Every security-based swap dealer or major security-based swap participant subject to § 240.18a-5(b) must preserve for a period not less than six years, the first two years in an easily accessible place, all records required to be made pursuant to paragraphs § 240.18a-5(b)(1), (b)(2), and (b)(3).

(b)(1) Every security-based swap dealer and major security-based swap participant subject to § 240.18a-5(a) must preserve for a period of not less than three years, the first two years in an easily accessible place:

(i) All records required to be made pursuant to §§ 240.18a-5(a)(5), (a)(6), (a)(7), (a)(8), (a)(9), (a)(11), (a)(12), (a)(13), (a)(14), (a)(15), (a)(16), and (a)(17);

(ii) All check books, bank statements, cancelled checks and cash reconciliations;

(iii) All bills receivable or payable (or copies thereof), paid or unpaid, relating to the business of such security-based swap dealer or major security-based swap participant, as such;

(iv) Originals of all communications received and copies of all communications sent (and any approvals thereof) by the security-based swap dealer or major security-based swap participant (including inter-office memoranda and communications) relating to its business as such. As used in this paragraph (b)(1)(iv), the term communications includes sales scripts and recordings of telephone calls required to be maintained pursuant to section 15F(g)(1) of the Act (15 U.S.C. 78o-10(g)(1));

(v) All trial balances and computations of net capital or tangible net worth requirements (and working papers in connection therewith), as applicable, financial statements, branch office reconciliations, and internal audit working papers, relating to the business of such security-based swap dealer or major security-based swap participant as such;

(vi) All guarantees of security-based swap accounts and all powers of attorney and other evidence of the granting of any discretionary authority given in respect of any security-based swap account, and copies of resolutions empowering an agent to act on behalf of a corporation.

(vii) All written agreements (or copies thereof) entered into by such security-based swap dealer or major security-based swap participant relating to its business as such, including agreements with respect to any account. Written agreements with respect to a security-based swap customer or non-customer, including governing documents or any document establishing the terms and conditions of the customer's or non-customer's securities-based swaps must be maintained with the customer's or non-customer's account records.

(viii) Records which contain the following information in support of amounts included in the report prepared as of the audit date on Form SBS (§ 249.617 of this chapter) and in annual audited financial statements required by § 240.18a-7(d):

(A) Money balance and position, long or short, including description, quantity, price, and valuation of each security including contractual commitments in security-based swap customers' accounts, in fully secured accounts, partly secured accounts, unsecured accounts, and in securities accounts payable to security-based swap customers;

(B) Money balance and position, long or short, including description, quantity, price, and valuation of each security including contractual commitments in security-based swap non-customers' accounts, in fully secured accounts, partly secured accounts, unsecured accounts, and in security-based swap accounts payable to security-based swap customers;

(C) Position, long or short, including description, quantity, price and valuation of each security including contractual commitments included in the Computation of Net Capital as

commitments, securities owned, securities owned not readily marketable, and other investments owned not readily marketable;

(D) Description of futures commodity contracts or swaps, contract value on trade date, market value, gain or loss, and liquidating equity or deficit in customers' and non-customers' accounts;

(E) Description of futures commodity contracts or swaps, contract value on trade date, market value, gain or loss and liquidating equity or deficit in trading and investment accounts;

(F) Description, money balance, quantity, price, and valuation of each spot commodity, and swap position or commitments in customers' and non-customers' accounts;

(G) Description, money balance, quantity, price, and valuation of each spot commodity, and swap position or commitments in trading and investment accounts;

(H) Number of shares, description of security, exercise price, cost, and market value of put and call options including short out of the money options having no market or exercise value, showing listed and unlisted put and call options separately;

(I) Quantity, price, and valuation of each security underlying the haircut for undue concentration made in the Computation for Net Capital;

(J) Description, quantity, price, and valuation of each security and commodity position or contractual commitment, long or short, in each joint account in which the security-based swap dealer or major security-based swap participant has an interest, including each participant's interest and margin deposit;

(K) Description, settlement date, contract amount, quantity, market price, and valuation for each aged failed to deliver requiring a charge in the Computation of Net Capital pursuant to § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012];

(L) Detail relating to information for possession or control requirements under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] and reported on Form SBS (§ 249.617 of this chapter);

(M) Detail of all items, not otherwise substantiated, which are charged or credited in the Computation of Net Capital pursuant to § 240.18a-1 and § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], such as cash margin deficiencies, deductions related to securities values and undue concentration, aged securities differences, and insurance claims receivable;

(N) Detail relating to the calculation of the risk margin amount pursuant to § 240.18a-1(c)(6) [as proposed at 77 FR 70214, Nov. 23, 2012]; and;

(O) Other schedules which are specifically prescribed by the Commission as necessary to support information reported as required by § 240.18a-7;

(ix) The records required to be made pursuant to § 240.15c3-4 and the results of the periodic reviews conducted pursuant to § 240.15c3-4(d);

(x) The records required to be made pursuant to § 240.18a-1(e)(2)(iv)(F)(1) and (2) [as proposed at 77 FR 70214, Nov. 23, 2012];

(xi) A copy of information required to be reported under Regulation SBSR § 242.901 et seq. of this chapter;

(xii) Copies of documents, communications, disclosures, and notices related to business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-6 and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011];

(xiii) Copies of documents used to make a reasonable determination with respect to special entities, including information relating to the financial status, the tax status, the

investment or financing objectives of the special entity as required under section 15F(h)(4)(C) and (5)(A) of the Act (15 U.S.C. 78o-10(h)(4)(C) and (5)(A)).

(2) Every security-based swap dealer and major security-based swap participant subject to § 240.18a-5(b) must preserve for a period of not less than three years, the first two years in an easily accessible place:

(i) All records required to be made pursuant to § 240.18a-5(b)(4), (b)(5), (b)(6), (b)(7), (b)(9), (b)(10), (b)(11), (b)(12), and (b)(13).

(ii) Originals of all communications received and copies of all communications sent (and any approvals thereof) by the security-based swap dealer or major security-based swap participant (including inter-office memoranda and communications) relating to its business as a security-based swap dealer or major security-based swap dealer. As used in this paragraph (b)(2)(ii), the term communications includes sales scripts and recordings of telephone calls required to be maintained pursuant to section 15F(g)(1) of the Act (15 U.S.C. 78o-10(g)(1)).

(iii) All guarantees of security-based swap accounts and all powers of attorney and other evidence of the granting of any discretionary authority given in respect of any security-based swap account, and copies of resolutions empowering an agent to act on behalf of a corporation.

(iv) All written agreements (or copies thereof) entered into by such security-based swap dealer or major security-based swap participant relating to its business as a security-based swap dealer or major security-based swap participant, including agreements with respect to any account. Written agreements with respect to a security-based swap customer or non-customer, including governing documents or any document establishing the terms and conditions of the customer's or non-customer's securities-based swaps must be maintained with the customer's or non-customer's account records.

(v) Records which contain detail relating to information for possession or control requirements under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] and reported on Form SBS (§ 249.617 of this chapter) that is in support of amounts included in the report prepared as of the audit date on Form SBS (§ 249.617 of this chapter) and in annual audited financial statements required by § 240.18a-7(d).

(vi) A copy of information required to be reported under Regulation SBSR § 242.901 et seq. of this chapter;

(vii) Copies of documents, communications, disclosures, and notices related to business conduct standards as required under § 240.15Fh-1 through § 240.15Fh-6 and § 240.15Fk-1 [as proposed at 76 FR 42396, July 18, 2011]; and

(viii) Copies of documents used to make a reasonable determination with respect to special entities, including information relating to the financial status, the tax status, the investment or financing objectives of the special entity as required under sections 15F(h)(4)(C) and (5)(A) of the Act (15 U.S.C. 78o-10(h)(4)(C) and (5)(A)).

(c) Every security-based swap dealer and major security-based swap participant subject to § 240.18a-5(a) must preserve during the life of the enterprise and of any successor enterprise all partnership articles or, in the case of a corporation, all articles of incorporation or charter, minute books and stock certificate books (or, in the case of any other form of legal entity, all records such as articles of organization or formation, and minute books used for a purpose similar to those records required for corporation or partnerships), all Forms SBSE (§ 249.617 of this chapter), Forms SBSE-A, Forms SBSE-W (§ 249.617 of this chapter), all amendments to these forms, all licenses or other documentation showing the registration of the security-based swap dealer or major security-based swap participant with any securities regulatory authority.

(d) Every security-based swap dealer and major security-based swap participant subject to § 240.18a-5 must maintain and preserve in an easily accessible place:

(1) All records required under § 240.18a-5(a)(10) or (b)(8) until at least three years after the associated person's employment and any other connection with the security-based swap dealer or major security-based swap participant has terminated.

(2)(i) For security-based swap dealers and major security-based swap participants for which there is not a prudential regulator, each report which a regulatory authority has requested or required the security-based swap dealer or major security-based swap participant to make and furnish to it pursuant to an order or settlement, and each regulatory authority examination report until three years after the date of the report.

(ii) For security-based swap dealers and major security-based swap participants for which there is a prudential regulator, each report related to security-based swap activities which a regulatory authority has requested or required the security-based swap dealer or major security-based swap participant to make and furnish to it pursuant to an order or settlement, and each regulatory authority examination report until three years after the date of the report.

(3)(i) For security-based swap dealers and major security-based swap participants for which there is not a prudential regulator, each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the security-based swap dealer or major security-based swap participant with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the security-based swap dealer or major security-based swap participant until three years after the termination of the use of the manual.

(ii) For security-based swap dealers and major security-based swap participants for which there is a prudential regulator, each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the security-based swap dealer or major security-based swap participant with respect to compliance with applicable laws and rules relating to security-based swap activities, and supervision of the activities of each natural person associated with the security-based swap dealer or major security-based swap participant until three years after the termination of the use of the manual.

(e) The records required to be maintained and preserved pursuant to §§ 240.18a-5 and 240.18a-6 may be immediately produced or reproduced by means of "electronic storage media" (as defined in this section) that meet the conditions set forth in this paragraph and be maintained and preserved for the required time in that form.

(1) For purposes of this section, the term electronic storage media means any digital storage medium or system that meets the applicable conditions set forth in this paragraph (e).

(2) If electronic storage media is used by a security-based swap dealer or major security-based swap participant, it must comply with the following requirements:

(i) If employing any electronic storage media other than optical disk technology (including CD-ROM), the security-based swap dealer or major security-based swap participant must notify the Commission at least 90 days prior to employing such storage media. The security-based swap dealer or major security-based swap participant must provide its own representation or one from the storage medium vendor or other third party with appropriate expertise that the selected storage media meets the conditions set forth in this paragraph (e)(2).

(ii) The electronic storage media must:

- (A) Preserve the records exclusively in a non-rewritable, non-erasable format;
- (B) Verify automatically the quality and accuracy of the storage media recording process;
- (C) Serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media; and
- (D) Have the capacity to readily download indexes and records preserved on the electronic storage media to any medium acceptable under this paragraph (e) as required by the Commission.

(3) If a security-based swap dealer or major security-based swap participant uses electronic storage media, it must:

- (i) At all times have available, for examination by the staff of the Commission, facilities for immediate, easily readable projection or productions of electronic storage media images and for producing easily readable images;

- (ii) Be ready at all times to provide, and immediately provide, any facsimile enlargement which the staff of the Commission may request;

- (iii) Store separately from the original, a duplicate copy of the record stored on any medium acceptable under § 240.18a-6 for the time required; and

- (iv) Organize and index accurately all information maintained on both original and any duplicate storage media.

(A) At all times, a security-based swap dealer or major security-based swap participant must be able to have such indexes available for examination by the staff of the Commission.

(B) Each index must be duplicated and the duplicate copies must be stored separately from the original copy of each index.

(C) Original and duplicate indexes must be preserved for the time required for the indexed records.

(v) The security-based swap dealer or major security-based swap participant must have in place an audit system providing for accountability regarding inputting of records required to be maintained and preserved pursuant to §§ 240.18a-5 and 240.18a-6 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby.

(A) At all times the security-based swap dealer or major security-based swap participant must be able to have the results of such audit system available for examination by the staff of the Commission.

(B) The audit results must be preserved for the time required for the audited records.

(vi) The security-based swap dealer or major security-based swap participant must maintain, keep current, and provide promptly upon request by the staff of the Commission all information necessary to access records and indexes stored on the electronic storage media; or place in escrow and keep current a copy of the physical and logical file format of the electronic storage media, the field format of all different information types written on the electronic storage media and the source code, together with the appropriate documentation and information necessary to access records and indexes.

(vii) For every security-based swap dealer or major security-based swap participant exclusively using electronic storage media for some or all of its record preservation under this section, at least one third party ("the undersigned"), who has access to and the ability to

download information from the security-based swap dealer's or major security-based swap participant's electronic storage media to any acceptable medium under this section, must file with the Commission the following undertakings with respect to such records:

The undersigned hereby undertakes to furnish promptly to the U.S. Securities and Exchange Commission ("Commission"), its designees or representatives, upon reasonable request, such information as is deemed necessary by the staff of the Commission, to download information kept on the security-based swap dealer's or major security-based swap participant's electronic storage media to any medium acceptable under § 240.18a-6 under the Act.

Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the security-based swap dealer's or major security-based swap participant's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved pursuant to §§ 240.18a-5 and 240.18a-6 under the Act in a format acceptable to the staff of the Commission. Such arrangements will provide specifically that in the event of a failure on the part of a security-based swap dealer or major security-based swap participant to download the record into a readable format and after reasonable notice to the security-based swap dealer or major security-based swap participant, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, as the staff of the Commission may request.

(f) If the records required to be maintained and preserved pursuant to the provisions of §§ 240.18a-5 and 240.18a-6 are prepared or maintained by a third party on behalf of the security-based swap dealer or major security-based swap participant, the third party must file with the

Commission a written undertaking in form acceptable to the Commission, signed by a duly authorized person, to the effect that such records are the property of the security-based swap dealer or major security-based swap participant and will be surrendered promptly on request of the security-based swap dealer or major security-based swap participant and including the following provision:

With respect to any books and records maintained or preserved on behalf of [SBSD or MSBSP], the undersigned hereby undertakes to permit examination of such books and records at any time or from time to time during business hours by representatives or designees of the Securities and Exchange Commission, and to promptly furnish to said Commission or its designee true, correct, complete, and current hard copy of any or all or any part of such books and records.

Agreement with an outside entity will not relieve such security-based swap dealer or major security-based swap participant from the responsibility to prepare and maintain records as specified in this section or in § 240.18a-5.

(g) Every security-based swap dealer and major security-based swap participant subject to this section must furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the security-based swap dealer or major security-based swap participant that are required to be preserved under this section, or any other records of the security-based swap dealer or major security-based swap participant subject to examination or required to be made or maintained pursuant to section 15F of the Act (15 U.S.C. 78o-10), which are requested by a representative of the Commission.

(h) When used in this section:

(1) The term securities regulatory authority means the Commission, any self-regulatory organization, or any securities commission (or any agency or office performing like functions) of the States; the Commodities Futures Trading Commission and a prudential regulator to the extent the prudential regulator oversees security-based swap activities.

(2) The term associated person has the meaning set forth in § 240.18a-5(c).

§ 240.18a-7 Reports to be made by certain security-based swap dealers and major security-based swap participants.

Section 240.18a-7 applies to a security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act (15 U.S.C. 78o-8(b)) that is not also registered as a broker or dealer under section 15(b) of the Act (15 U.S.C. 78o(b)). A broker or dealer registered under section 15(b) of the Act, including a broker or dealer registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act, is subject to the reporting requirements under § 240.17a-5.

(a)(1) Every security-based swap dealer or major security-based swap participant for which there is no prudential regulator must file an executed Form SBS with the Commission or its designee within 17 business days after the end of each month.

(2) Every security-based swap dealer or major security-based swap participant for which there is a prudential regulator must file an executed Form SBS with the Commission or its designee within 17 business days after the end of each calendar quarter.

(3) Security-based swap dealers that have been authorized by the Commission to compute net capital pursuant to § 240.18a-1(d) [as proposed at 77 FR 70214, Nov. 23, 2012], must file the following:

(i) For each product for which the security-based swap dealer calculates a deduction for market risk other than in accordance with a model approved pursuant to §§ 240.18a-1(e)(1)(i) and (iii) [as proposed at 77 FR 70214, Nov. 23, 2012], the product category and the amount of the deduction for market risk within 17 business days after the end of the month;

(ii) A graph reflecting, for each business line, the daily intra-month value at risk within 17 business days after the end of the month;

(iii) The aggregate value at risk for the security-based swap dealer within 17 business days after end of the month;

(iv) For each product for which the security-based swap dealer uses scenario analysis, the product category and the deduction for market risk within 17 business days after the end of the month;

(v) Credit risk information on security-based swap, mixed swap and swap exposures, within 17 business days after the end of the month, including:

(A) Overall current exposure;

(B) Current exposure (including commitments) listed by counterparty for the 15 largest exposures;

(C) The ten largest commitments listed by counterparty;

(D) The broker's or dealer's maximum potential exposure listed by counterparty for the 15 largest exposures;

(E) The broker's or dealer's aggregate maximum potential exposure;

(F) A summary report reflecting the broker's or dealer's current and maximum potential exposures by credit rating category; and

(G) A summary report reflecting the broker's or dealer's current exposure for each of the top ten countries to which the broker or dealer is exposed (by residence of the main operating group of the counterparty);

(vi) Regular risk reports supplied to the security-based swap dealer's senior management within 17 business days after the end of the month;

(vii) The results of the liquidity stress test required by § 240.18a-1(f) [as proposed at 77 FR 70214, Nov. 23, 2012] within 17 business days after the end of the month;

(viii) A report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR within 17 business days after the end of each calendar quarter; and

(ix) The results of backtesting of all internal models used to compute allowable capital, including VaR, and credit risk models, indicating the number of backtesting exceptions within 17 business days after the end of each calendar quarter.

(b) Customer Disclosures

(1) Every security-based swap dealer or major security-based swap participant for which there is no prudential regulator must make publicly available on its website within 10 business days after the date the firm is required to file with the Commission the annual reports pursuant to paragraph (c) of this section:

(i) A Statement of Financial Condition with appropriate notes prepared in accordance with U.S. generally accepted accounting principles which must be audited;

(ii) A statement of the amount of the security-based swap dealer's net capital and its required net capital, computed in accordance with § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012]. Such statement must include summary financial statements of subsidiaries

consolidated pursuant to Appendix C of § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012], where material, and the effect thereof on the net capital and required net capital of the security-based swap dealer; and

(iii) If, in connection with the most recent annual reports required under paragraph (c) of this section, the report of the independent public accountant required under paragraph (c)(1)(i)(C) of this section covering the report of the security-based swap dealer required under paragraph (c)(1)(i)(B) of this section identifies one or more material weaknesses, a copy of the report.

(2) Every security-based swap dealer or major security-based swap participant for which there is no prudential regulator must make publicly available on its website unaudited statements as of the date that is 6 months after the date of the most recent audited statements filed with the Commission under paragraph (c)(1) of this section. These reports must be made publicly available within 30 calendar days of the date of the statements.

(3) The information that is made publicly available pursuant to paragraphs (b)(1) and (2) of this section must also be made available in writing, upon request, to any person that has a security-based swap account. The security-based swap dealer or major security-based swap participant must maintain a toll-free telephone number to receive such requests.

(c) Annual reports. (1)(i) Except as otherwise provided in paragraph (c)(1)(iii) of this section, every security-based swap dealer or major security-based swap participant for which there is no prudential regulator registered under section 15F of the Act (15 U.S.C. 78o-10) must file annually, as applicable:

(A) A financial report as described in paragraph (c)(2) of this section;

(B) For a security-based swap dealer, a compliance report as described in paragraph (c)(3) of this section; and

(C) A report prepared by an independent public accountant, under the engagement provisions in paragraph (e) of this section, covering each report required to be filed under paragraphs (c)(1)(i)(A) and (B) of this section, as applicable.

(ii) The reports required to be filed under this paragraph (c) must be as of the same fiscal year end each year, unless a change is approved in writing by the Commission. The original request for a change should be filed at the Commission's principal office in Washington, DC. A copy of the written approval must be sent to the regional office of the Commission for the region in which the security-based swap dealer or major security-based swap participant has its principal place of business.

(iii) A security-based swap dealer or major security-based swap participant succeeding to and continuing the business of another security-based swap dealer or major security-based swap participant is not required to file reports under this paragraph (c) as of a date in the fiscal year in which the succession occurs if the predecessor security-based swap dealer or major security-based swap participant has filed the reports in compliance with this paragraph (c) as of a date in such fiscal year.

(2) Financial report. The financial report must contain:

(i) A Statement of Financial Condition, a Statement of Income, a Statement of Cash Flows, a Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and Statement of Changes in Liabilities Subordinated to Claims of General Creditors. The statements must be prepared in accordance with U.S. generally accepted accounting principles

and must be in a format that is consistent with the statements contained in Form SBS (§ 249.617 of this chapter).

(ii) Supporting schedules that include, from Form SBS (§ 249.617 of this chapter), including a Computation of Net Capital under § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012], the Computation for Determination of Tangible Net Worth under § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], a Computation for Determination of the Reserve Requirements under Exhibit A of § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], and Information Relating to the Possession or Control Requirements Under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], as applicable.

(iii) If either the Computation of Net Capital under § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012], the Computation for Determination of Tangible Net Worth under § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012] or the Computation for Determination of the Reserve Requirements under § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] in the financial report is materially different from the corresponding computation in the most recent Form SBS (§ 249.617 of this chapter) filed pursuant to paragraph (a) of this section, a reconciliation, including appropriate explanations, between the computation in the financial report and the computation in the most recently filed report, or if no material differences exist, a statement so indicating must be included in the financial report.

(3) Compliance report. (i) The compliance report must contain:

(A) Statements as to whether:

(1) The security-based swap dealer has established and maintained Internal Control Over Compliance as that term is defined in paragraph (c)(3)(ii) of this section;

(2) The Internal Control Over Compliance of the security-based swap dealer was effective during the most recent fiscal year;

(3) The Internal Control Over Compliance of the security-based swap dealer was effective as of the end of the most recent fiscal year;

(4) The security-based swap dealer was in compliance with §§ 240.18a-1 and 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012];

(5) The information used to assert compliance with §§ 240.18a-1 and 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] was derived from the books and records of the security-based swap dealer; and

(B) If applicable, a description of each identified material weakness in the Internal Control Over Compliance of the security-based swap dealer during the most recent fiscal year;

(C) If applicable, a description of an instance of non-compliance with §§ 240.18a-1 or 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012] as of the end of the most recent fiscal year.

(ii) The term Internal Control Over Compliance means internal controls that have the objective of providing the security-based swap dealer with reasonable assurance that non-compliance with §§ 240.18a-1, 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012], or 240.18a-9 will be prevented or detected on a timely basis.

(iii) The security-based swap dealer is not permitted to conclude that its Internal Control Over Compliance was effective during the most recent fiscal year if there were one or more material weaknesses in its Internal Control Over Compliance during the most recent fiscal year. The security-based swap dealer is not permitted to conclude that its Internal Control Over Compliance was effective as of the end of the most recent fiscal year if there were one or more

material weaknesses in its internal control as of the end of the most recent fiscal year. A material weakness is a deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with §§ 240.18a-1 or 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012] will not be prevented, or detected on a timely basis or that non-compliance to a material extent with § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], except for paragraph (c), or § 240.18a-9 will not be prevented or detected on a timely basis. A deficiency in Internal Control Over Compliance exists when the design or operation of a control does not allow the management or employees of the security-based swap dealer in the normal course of performing their assigned functions, to prevent or detect on a timely basis non-compliance with § 240.18a-1, § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], or § 240.18a-9.

(4) The annual reports must be filed not more than 60 calendar days after the end of the fiscal year of the security-based swap dealer or major security-based swap participant.

(5) The annual reports must be filed at the regional office of the Commission for the region in which the security-based swap dealer or major security-based swap participant has its principal place of business and the Commission's principal office in Washington, DC.

(d) Nature and form of reports. The annual reports filed pursuant to paragraph (c) of this section must be prepared and filed in accordance with the following requirements:

(1) The security-based swap dealer or major security-based swap participant must attach to each of the confidential and non-confidential portions of the annual reports separately bound under paragraph (e)(2) of this section a complete and executed Part III of Form X-17A-5 (§ 249.617 of this chapter). The oath or affirmation made in Part III of Form X-17A-5 must be made before a person duly authorized to administer such oaths or affirmations. If the security-

based swap dealer or major security-based swap participant is a sole proprietorship, the oath or affirmation must be made by the proprietor; if a partnership, by a general partner; if a corporation, by a duly authorized officer; or if a limited liability company or limited liability partnership, by the chief executive officer, chief financial officer, manager, managing member, or those members vested with management authority for the limited liability company or limited liability partnership.

(2) The annual reports filed under paragraph (c) of this section are not confidential, except that, if the Statement of Financial Condition is in a format that is consistent with Form SBS (§ 249.617 of this chapter), and is bound separately from the balance of the annual reports filed under paragraph (c) of this section, and each page of the balance of the annual report is stamped "confidential," then the balance of the annual reports will be deemed confidential to the extent permitted by law. However, the annual reports, including the confidential portions, will be available for official use by any official or employee of the U.S. or any State, by the Public Company Accounting Oversight Board, and by any other person if the Commission authorizes disclosure of the annual reports to that person as being in the public interest. Nothing contained in this paragraph (d)(2) may be construed to be in derogation of the right of customers of a security-based swap dealer or major security-based swap participant, upon request to the security-based swap dealer or major security-based swap participant, to obtain information relative to its financial condition.

(e)(1) Qualifications of independent public accountant. The independent public accountant must be qualified and independent in accordance with § 210.2-01 of this chapter. In addition, the accountant must be registered with the Public Company Accounting Oversight Board.

(2) Statement regarding independent public accountant. (i) Every security-based swap dealer or major security-based swap participant that is required to file annual reports under paragraph (c) of this section must file no later than December 10 of each year (or 30 days after effective date of registration as a security-based swap dealer or major security-based swap participant if earlier) a statement as prescribed in paragraph (e)(2)(ii) of this section with the Commission's principal office in Washington, DC and the regional office of the Commission for the region in which its principal place of business is located. Such statement must be dated no later than December 1 (or 20 calendar days after the effective date of its registration as a security-based swap dealer or major security-based swap participant, if earlier). If the engagement of an independent public accountant is of a continuing nature, providing for successive engagements, no further filing is required. If the engagement is for a single year, or if the most recent engagement has been terminated or amended, a new statement must be filed by the required date.

(ii) The statement must be headed "Statement regarding independent public accountant under Rule 18a-7(e)(2)" and must contain the following information and representations:

(A) Name, address, telephone number and registration number of the security-based swap dealer or major security-based swap participant;

(B) Name, address, and telephone number of the independent public accountant;

(C) The date of the fiscal year of the annual reports of the security-based swap dealer or major security-based swap participant covered by the engagement;

(D) Whether the engagement is for a single year or is of a continuing nature;

(E) A representation that the independent public accountant has undertaken the items enumerated in paragraphs (f)(1) and (2) of this section.

(3) Replacement of accountant. A security-based swap dealer or major security-based swap participant must file a notice which must be received by the Commission's principal office in Washington, DC and the regional office of the Commission for the region in which its principal place of business is located not more than 15 business days after:

(i) The security-based swap dealer or major security-based swap participant has notified the independent public accountant that provided the reports the security-based swap dealer or major security-based swap participant filed under paragraph (c)(1)(i)(C) of this section for the most recent fiscal year that the independent public accountant's services will not be used in future engagements; or

(ii) The security-based swap dealer or major security-based swap participant has notified an independent public accountant that was engaged to provide the reports required under paragraph (c)(1)(i)(C) of this section that the engagement has been terminated; or

(iii) An independent public accountant has notified the security-based swap dealer or major security-based swap participant that the independent public accountant would not continue under an engagement to provide the reports required under paragraph (c)(1)(i)(C) of this section; or

(iv) A new independent public accountant has been engaged to provide the reports required under paragraph (c)(1)(i)(C) of this section without any notice of termination having been given to or by the previously engaged independent public accountant.

(v) The notice must include:

(A) The date of notification of the termination of the engagement or of the engagement of the new independent public accountant, as applicable; and

(B) The details of any issues arising during the 24 months (or the period of the engagement, if less than 24 months) preceding the termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure, or compliance with applicable rules of the Commission, which issues, if not resolved to the satisfaction of the former independent public accountant, would have caused the independent public accountant to make reference to them in the report of the independent public accountant. The issues required to be reported include both those resolved to the former independent public accountant's satisfaction and those not resolved to the former accountant's satisfaction. Issues contemplated by this section are those which occur at the decision-making level – that is, between principal financial officers of the security-based swap dealer or major security-based swap participant and personnel of the accounting firm responsible for rendering its report. The notice must also state whether the accountant's report filed under paragraph (c)(1)(i)(C) of this section for any of the past two fiscal years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles, and must describe the nature of each such adverse opinion, disclaimer of opinion, or qualification. The security-based swap dealer or major security-based swap participant must also request the former independent public accountant to furnish the security-based swap dealer or major security-based swap participant with a letter addressed to the Commission stating whether the independent public accountant agrees with the statements contained in the notice of the security-based swap dealer or major security-based swap participant and, if not, stating the respects in which the independent public accountant does not agree. The security-based swap dealer or major security-based swap participant must file three copies of the notice and the accountant's letter, one copy of which must be manually signed by the sole proprietor, or a

general partner or a duly authorized corporate, limited liability company, or limited liability partnership officer or member, as appropriate, and by the independent public accountant, respectively.

(f) Engagement of the independent public accountant. The independent public accountant engaged by the security-based swap dealer or major security-based swap participant to provide the reports required under paragraph (c)(1)(i)(C) of this section must, as part of the engagement, undertake the following, as applicable:

(1) To prepare an independent public accountant's report based on an examination of the financial report required to be filed by the security-based swap dealer or major security-based swap participant under paragraph (c)(1)(i)(A) of this section in accordance with standards of the Public Company Accounting Oversight Board; and

(2) To prepare an independent public accountant's report based on an examination of the statements required under paragraphs (c)(3)(i)(A)(2) through (5) of this section in the compliance report required to be filed by the security-based swap dealer under paragraph (c)(1)(i)(B) of this section in accordance with standards of the Public Company Accounting Oversight Board.

(g) Notification of non-compliance or material weakness. If, during the course of preparing the independent public accountant's reports required under paragraph (c)(1)(i)(C) of this section, the independent public accountant determines that:

(1) A security-based swap dealer is not in compliance with § 240.18a-1, § 240.18a-4 [as proposed at 77 FR 70214, Nov. 23, 2012], or § 240.18a-9, or the independent public accountant determines that any material weaknesses (as defined in paragraph (c)(3)(iii) of this section) exist, the independent public accountant must immediately notify the chief financial officer of the security-based swap dealer of the nature of the non-compliance or material weakness. If the

notice from the accountant concerns an instance of non-compliance that would require a security-based swap dealer to provide a notification under § 240.18a-8 or if the notice concerns a material weakness, the security-based swap dealer must provide a notification in accordance with § 240.18a-8, as applicable, and provide a copy of the notification to the independent public accountant. If the independent public accountant does not receive the notification within one business day, or if the independent public accountant does not agree with the statements in the notification, then the independent public accountant must notify the Commission within one business day. The report from the accountant must, if the security-based swap dealer failed to file a notification, describe any instances of non-compliance that required a notification under § 240.18a-8 or any material weakness. If the security-based swap dealer filed a notification, the report from the accountant must detail the aspects of the notification of the security-based swap dealer with which the accountant does not agree; or

(2) A major security-based swap participant is not in compliance with § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], the independent public accountant must immediately notify the chief financial officer of the major security-based swap participant of the nature of the non-compliance. If the notice from the accountant concerns an instance of non-compliance that would require a major security-based swap participant to provide a notification under § 240.18a-8, the major security-based swap participant must provide a notification in accordance with § 240.18a-8 and provide a copy of the notification to the independent public accountant. If the independent public accountant does not receive the notification within one business day, or if the independent public accountant does not agree with the statements in the notification, then the independent public accountant must notify the Commission within one business day. The report from the accountant must, if the major security-based swap participant failed to file a

notification, describe any instances of non-compliance that required a notification under § 240.18a-8. If the major security-based swap participant filed a notification, the report from the accountant must detail the aspects of the notification of the major security-based swap participant with which the accountant does not agree.

Note to paragraph (g): The attention of the security-based swap dealer, major security-based swap participant, and the independent public accountant is called to the fact that under § 240.18a-8(a), among other things, a security-based swap dealer or major security-based swap participant whose net capital or tangible net worth, as applicable, declines below the minimum required pursuant to § 240.18a-1 or § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], as applicable, must give notice of such deficiency that same day in accordance with § 240.18a-8(h) and the notice must specify the security-based swap dealer's net capital requirement and its current amount of net capital, or the extent of the major security-based swap participant's failure to maintain positive tangible net worth, as applicable.

(h) Reports of the independent public accountant required under paragraph (c)(1)(i)(C) of this section.

(1) Technical requirements. The independent public accountant's reports must:

- (i) Be dated;
- (ii) Be signed manually;
- (iii) Indicate the city and state where issued; and
- (iv) Identify without detailed enumeration the items covered by the reports.

(2) Representations. The independent public accountant's reports must:

- (i) State whether the examinations were made in accordance with standards of the Public Company Accounting Oversight Board; and

(ii) Identify any examination procedures deemed necessary by the independent public accountant under the circumstances of the particular case which have been omitted and the reason for their omission.

(iii) Nothing in this section may be construed to imply authority for the omission of any procedure that independent public accountants would ordinarily employ in the course of an examination for the purpose of expressing the opinions required under this section.

(3) Opinion to be expressed. The independent public accountant's reports must state clearly:

(i) The opinion of the independent public accountant with respect to the financial report required under paragraph (c)(1)(i)(C) of this section and the accounting principles and practices reflected in that report; and

(ii) The opinion of the independent public accountant with respect to the financial report required under paragraph (c)(1)(i)(C) of this section, as to the consistency of the application of the accounting principles, or as to any changes in those principles which have a material effect on the financial statements; and

(iii) The opinion of the independent public accountant with respect to the statements required under paragraphs (c)(3)(i)(A)(2) through (5) of this section in the compliance report required under paragraph (c)(1)(i)(B) of this section.

(4) Exceptions. Any matters to which the independent public accountant takes exception must be clearly identified, the exceptions must be specifically and clearly stated, and, to the extent practicable, the effect of each such exception on any related items contained in the annual reports required under paragraph (c) of this section must be given.

(i) Extensions and exemptions – on written request of a security-based swap dealer or major security-based swap participant to the Commission or on its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of this section either unconditionally or on specified terms and conditions.

(j) Notification of change of fiscal year –

(1) In the event any security-based swap dealer or major security-based swap participant for which there is no prudential regulator finds it necessary to change its fiscal year, it must file, with the Commission's principal office in Washington, DC and the regional office of the Commission for the region in which the security-based swap dealer or major security-based swap participant has its principal place of business, a notice of such change.

(2) Such notice must contain a detailed explanation of the reasons for the change. Any change in the filing period for the annual reports must be approved by the Commission.

(k) Filing Requirements. For purposes of filing requirements as described in this section, filing will be deemed to have been accomplished upon receipt at the Commission's principal office in Washington, DC, with duplicate originals simultaneously filed at the locations prescribed in the particular paragraph of this section which is applicable.

§ 240.18a-8 Notification provisions for security-based swap dealers and major security-based swap participants.

Section 240.18a-8 applies to a security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act (15 U.S.C. 78o-8(b)) that is not also registered as a broker or dealer under section 15(b) of the Act (15 U.S.C. 78o(b)). A broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer registered as a security-based swap dealer or major security-based swap participant under section

15F(b) of the Act (15 U.S.C. 78o-10(b)), is subject to the notification requirements under § 240.17a-11.

(a)(1)(i) Every security-based swap dealer for which there is no prudential regulator whose net capital declines below the minimum amount required pursuant to § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] must give notice that same day in accordance with paragraph (h) of this section. The notice must specify the security-based swap dealer's net capital requirement and its current amount of net capital. If a security-based swap dealer is informed by the Commission that it is, or has been, in violation of § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] and the security-based swap dealer has not given notice of the capital deficiency under this section, the security-based swap dealer, even if it does not agree that it is, or has been, in violation of § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012], must give notice of the claimed deficiency, which notice may specify the security-based swap dealer's reasons for its disagreement.

(ii) Every security-based swap dealer for which there is no prudential regulator whose tentative net capital declines below the minimum amount required pursuant to § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] must give notice that same day in accordance with paragraph (h) of this section. The notice must specify the security-based swap dealer's tentative net capital requirement and its current amount of tentative net capital, as appropriate. If a security-based swap is informed by the Commission that it is, or has been, in violation of § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] and the security-based swap dealer has not given notice of the capital deficiency under this section, the security-based swap dealer, even if it does not agree that it is, or has been, in violation of § 240.18a-1 [as proposed at 77 FR

70214, Nov. 23, 2012], must give notice of the claimed deficiency, which notice may specify the security-based swap dealer's reasons for its disagreement.

(2) Every major security-based swap participant for which there is no prudential regulator who fails to maintain a positive tangible net worth pursuant to § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012] must give notice that same day in accordance with paragraph (h) of this section. The notice must specify the extent to which the firm has failed to maintain positive tangible net worth. If a major security-based swap participant is informed by the Commission that it is, or has been, in violation of § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012] and the major security-based swap participant has not given notice of the capital deficiency under this section, the major security-based swap participant, even if it does not agree that it is, or has been, in violation of § 240.18a-2 [as proposed at 77 FR 70214, Nov. 23, 2012], must give notice of the claimed deficiency, which notice may specify the major security-based swap participant's reasons for its disagreement.

(b) Every security-based swap dealer or major security-based swap participant for which there is no prudential regulator must send notice promptly (but within 24 hours) after the occurrence of the events specified in paragraphs (b)(1), (b)(2), (b)(3), or (b)(4) of this section, as applicable, in accordance with paragraph (i) of this section:

(1) If a computation made by a security-based swap dealer pursuant to § 240.18a-1 [as proposed at 77 FR 70214, Nov. 23, 2012] shows that its total net capital is less than 120 percent of the security-based swap dealer's required minimum net capital;

(2) If a computation made by a security-based swap dealer authorized by the Commission to compute net capital pursuant to § 240.18a-1(d) [as proposed at 77 FR 70214,

Nov. 23, 2012] shows that its total tentative net capital is less than 120 percent of the security-based swap dealer's required minimum tentative net capital;

(3) If the level of tangible net worth of a major security-based swap participant falls below \$20 million;

(4) The occurrence of the fourth and each subsequent backtesting exception under § 240.18a-1(d)(9) [as proposed at 77 FR 70214, Nov. 23, 2012] during any 250 business day measurement period.

(c) Every security-based swap dealer that files a notice of adjustment of its reported capital category with the Federal Reserve Board, the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation must give notice of this fact that same day by transmitting a copy notice of the adjustment of reported capital category in accordance with paragraph (h) of this section.

(d) Every security-based swap dealer or major security-based swap participant that fails to make and keep current the books and records required by §§ 240.18a-5 must give notice of this fact that same day in accordance with paragraph (h) of this section, specifying the books and records which have not been made or which are not current. The security-based swap dealer or major security-based swap participant must also transmit a report in accordance with paragraph (h) of this section within 48 hours of the notice stating what the security-based swap dealer or major security-based swap participant has done or is doing to correct the situation.

(e) Whenever any security-based swap dealer for which there is no prudential regulator discovers, or is notified by an independent public accountant under § 240.18a-7(g), of the existence of any material weakness, as defined in § 240.18a-7(c)(3)(iii), the security-based swap dealer must:

(1) Give notice, in accordance with paragraph (h) of this section, of the material weakness within 24 hours of the discovery or notification of the material weakness; and

(2) Transmit a report in accordance with paragraph (h) of this section within 48 hours of the notice stating what the security-based swap dealer has done or is doing to correct the situation.

(f) A security-based swap dealer that has been authorized by the Commission to compute net capital pursuant to § 240.18a-1(d) [as proposed at 77 FR 70214, Nov. 23, 2012] must give immediate notice in writing in accordance with paragraph (h) of this section if a liquidity stress test conducted pursuant to § 240.18a-1(f) [as proposed at 77 FR 70214, Nov. 23, 2012] indicates that the amount of liquidity reserve is insufficient.

(g) If a security-based swap dealer fails to make in its special account for the exclusive benefit of security-based swap customers a deposit, as required by § 240.18a-4(c) [as proposed at 77 FR 70214, Nov. 23, 2012], the security-based swap dealer must give immediate notice in writing in accordance with paragraph (h) of this section.

(h) Every notice or report required to be given or transmitted by this section must be given or transmitted to the principal office of the Commission in Washington, DC, the regional office of the Commission for the region in which the security-based swap dealer or major security-based swap participant has its principal place of business, and the Commodity Futures Trading Commission if the security-based swap dealer or major security-based swap participant is registered as a futures commission merchant with such Commission. For the purposes of this section, "notice" must be given or transmitted by facsimile transmission. The report required by paragraphs (d) or (e)(2) of this section may be transmitted by overnight delivery.

§ 240.18a-9 Quarterly security counts to be made by certain security-based swap dealers.

Section 240.18a-9 applies to a security-based swap dealer registered under 15F(b) of the Act (15 U.S.C. 78o-8(b)) that is not also registered as a broker or dealer under section 15(b) of the Act (15 U.S.C. 78o(b)); provided, however, that this § 240.18a-9 does not apply to a security-based swap dealer that has a prudential regulator. A broker or dealer registered under section 15(b) of the Act, including a broker or dealer registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act, is subject to the securities count requirements under § 240.17a-13.

(a) Any security-based swap dealer that is subject to the provisions of this rule must at least once in each calendar quarter-year:

(1) Physically examine and count all securities held including securities that are the subjects of repurchase or reverse repurchase agreements;

(2) Account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to its control or direction but not in its physical possession by examination and comparison of the supporting detailed records with the appropriate ledger control accounts;

(3) Verify all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to its control or direction but not in its physical possession, where such securities have been in said status for longer than thirty days;

(4) Compare the results of the count and verification with its records; and

(5) Record on the books and records of the security-based swap dealer all unresolved differences setting forth the security involved and date of comparison in a security count difference account no later than 7 business days after the date of each required quarterly security

examination, count, and verification in accordance with the requirements provided in paragraph (b) of this section. Provided, however, that no examination, count, verification, and comparison for the purpose of this section is within 2 months of or more than 4 months following a prior examination, count, verification, and comparison made hereunder.

(b) The examination, count, verification, and comparison may be made either as of a date certain or on a cyclical basis covering the entire list of securities. In either case the recordation must be effected within 7 business days subsequent to the examination, count, verification, and comparison of a particular security. In the event that an examination, count, verification, and comparison is made on a cyclical basis, it may not extend over more than 1 calendar quarter-year, and no security may be examined, counted, verified, or compared for the purpose of this rule within 2 months of or more than 4 months after a prior examination, count, verification, and comparison.

(c) The examination, count, verification, and comparison must be made or supervised by persons whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of the subject records.

(d) The Commission may, upon written request, exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any security-based swap dealer that satisfies the Commission that it is not necessary in the public interest and for the protection of investors to subject the particular security-based swap dealer to certain or all of the provisions of this section, because of the special nature of its business, the safeguards it has established for the protection of customers' funds and securities, or such other reason as the Commission deems appropriate.

* * * * *

PART 249 — FORMS, SECURITIES EXCHANGE ACT OF 1934

8. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

9. Subpart G is amended by revising the heading to read as follows:

Subpart G — Forms for Reports To Be Made by Certain Exchange Members, Brokers, Dealers, Security-Based Swap Dealers, and Major Security-Based Swap Participants

* * * * *

10. Section 249.617 is revised to read as follows:

§ 249.617 Form X-17A-5 and FOCUS Report Form SBS, information required of certain brokers, dealers, security-based swap dealers, and major security-based swap participants pursuant to sections 15F and 17 of the Securities Exchange Act of 1934 and § 240.17a-5, § 240.17a-10 and § 240.17a-11, § 240.17a-12, and § 240.18a-7 of this chapter, as applicable.

Appropriate parts of Form X-17A-5 and FOCUS Report Form SBS, as applicable, shall be used by brokers, dealers, security-based swap dealers, and major security-based swap participants required to file reports under § 240.17a-5, § 240.17a-10, and § 240.17a-11, § 240.17a-12, and § 240.18a-7 of this chapter, as applicable.

* * * * *

11. Part III of Form X-17A-5 (referenced in § 249.617 of this chapter) is revised to read as follows:

Note: The text of Part III of Form X-17A-5 does not and this amendment will not appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AUDITED ANNUAL REPORT
FORM X-17A-5
PART III

OMB APPROVAL	
OMB Number:	3235-0123
Expires:	
Estimated average burden hours per response:	
SEC FILE NUMBER	

FACING PAGE

Information Required Pursuant to Rules 17a-5, 17a-12, and 18a-7 under the Securities Exchange Act of 1934

REPORT FOR THE PERIOD BEGINNING _____ AND ENDING _____
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF FIRM: _____

TYPE OF REGISTRANT (check all applicable boxes): ☐ OTC derivatives dealer
☐ Broker-dealer ☐ Security-based swap dealer ☐ Major security-based swap participant

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. box no.)

(No. and Street)

(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT WITH REGARD TO THIS REPORT

(Name) (Area Code - Telephone Number) (Email Address)

B. ACCOUNTANT IDENTIFICATION

PCAOB-REGISTERED INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this report*

(Name - if individual, state last, first, and middle name)

(Address) (City) (State) (Zip Code)

(Date of Registration with PCAOB)

FOR OFFICIAL USE ONLY

* Claims for exemption from the requirement that the annual report be covered by the opinion of a PCAOB-registered independent public accountant must be supported by a statement of facts and circumstances relied on as the basis of the exemption. See 17 CFR 240.17a-5(e)(1)(ii), if applicable.

Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

OATH OR AFFIRMATION

I, _____, swear (or affirm) that, to the best of my knowledge and belief, the information contained in the audited annual report pertaining to the firm of _____, as of _____, 20____, is true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer, or director has any proprietary interest in any account classified solely as that of a customer, except as follows: _____

Signature: _____

Title: _____

Notary Public

This report** contains (check all applicable boxes):

- ☐ (a) Facing page.
- ☐ (b) Statement of financial condition.
- ☐ (c) Statement of income (loss).
- ☐ (d) Statement of cash flows.
- ☐ (e) Statement of changes in stockholders' equity or partners' or sole proprietor's capital.
- ☐ (f) Statement of changes in liabilities subordinated to claims of creditors.
- ☐ (g) Computation of net capital under 17 C.F.R. § 240.15c3-1.
- ☐ (h) Computation of net capital under 17 C.F.R. § 240.18a-1.
- ☐ (i) Computation of tangible net worth under 17 C.F.R. § 240.18a-2.
- ☐ (j) Computation for determination of reserve requirements pursuant to Exhibit A to 17 C.F.R. § 240.15c3-3.
- ☐ (k) Computation for determination of reserve requirements pursuant to Exhibit A to 17 C.F.R. § 240.18a-4.
- ☐ (l) Information relating to possession or control requirements under 17 C.F.R. § 240.15c3-3.
- ☐ (m) Information relating to possession or control requirements under 17 C.F.R. § 240.18a-4.
- ☐ (n) A reconciliation, including appropriate explanation of the computation of net capital under 17 C.F.R. § 240.15c3-1.
- ☐ (o) A reconciliation, including appropriate explanation of the computation of the reserve requirements under 17 C.F.R. § 240.15c3-3.
- ☐ (p) A reconciliation, including appropriate explanation of the computation of net capital under 17 C.F.R. § 240.18a-1.
- ☐ (q) A reconciliation, including appropriate explanation of the computation of tangible net worth under 17 C.F.R. § 240.18a-2.
- ☐ (r) A reconciliation, including appropriate explanation of the computation of reserve requirements under 17 C.F.R. § 240.18a-4.
- ☐ (s) A reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☐ (t) An oath or affirmation.
- ☐ (u) A copy of the SIPC Supplemental Report.
- ☐ (v) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit under 17 C.F.R. § 240.17a-12(k).
- ☐ (w) Exemption report in accordance with 17 C.F.R. § 240.17a-5.
- ☐ (x) Compliance report in accordance with 17 C.F.R. § 240.17a-5.
- ☐ (y) Compliance report in accordance with 17 C.F.R. § 240.18a-7.
- ☐ (z) Independent public accountant's report based on an examination of the financial report under 17 C.F.R. § 240.17a-5.
- ☐ (aa) Independent public accountant's report based on an examination of the financial statements under 17 C.F.R. § 240.17a-12.
- ☐ (bb) Independent public accountant's report based on an examination of the compliance report under 17 C.F.R. § 240.17a-5.
- ☐ (cc) Independent public accountant's report based on a review of the exemption report under 17 C.F.R. § 240.17a-5.
- ☐ (dd) Independent public accountant's report based on an examination of the financial report under 17 C.F.R. § 240.18a-7.
- ☐ (ee) Independent public accountant's report based on an examination of the compliance report under 17 C.F.R. § 240.18a-7.
- ☐ (ff) Other: _____

****To request confidential treatment of certain portions of this filing, see 17 C.F.R. § 240.17a-5(e)(3) or 17 C.F.R. § 240.18a-7(d)(2), as applicable.**

* * * * *

12. FOCUS Report Form SBS and the instructions thereto (referenced in § 249.617 of this chapter)

are added to read as follows:

Note: The text of FOCUS Report Form SBS and the instructions thereto will not appear in the Code of Federal Regulations.

**FOCUS
Report
FORM SBS
Cover Page**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
FOCUS REPORT (FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT)
FORM SBS**

OMB APPROVAL

OMB Number:
Expires:
Estimated average burden
hours per response:

(Please read instructions before preparing Form)

This report is being filed by an:

- | | |
|---|------------------------------|
| 1) SBSD without a prudential regulator and not registered as a broker-dealer (stand-alone SBSD)..... | ☐ 999 |
| 2) MSBSP without a prudential regulator and not registered as a broker-dealer (stand-alone MSBSP) | ☐ 999 |
| 3) SBSD without a prudential regulator and registered as a broker-dealer (broker-dealer SBSD) | ☐ 999 |
| 4) MSBSP without a prudential regulator and registered as a broker-dealer (broker-dealer MSBSP)..... | ☐ 999 |
| 5) SBSD with a prudential regulator (bank SBSD)..... | ☐ 999 |
| 6) MSBSP with a prudential regulator (bank MSBSP)..... | ☐ 999 |

This report is being filed pursuant to (check applicable block(s)):

- | | |
|--|-----------------------------|
| 1) Rule 17a-5(a)..... | ☐ 16 |
| 2) Rule 17a-5(b)..... | ☐ 17 |
| 3) Special request by DEA or the Commission..... | ☐ 19 |
| 4) Rule 18a-7 | ☐ 99 |
| 5) Other (explain: _____)..... | ☐ 26 |

NAME OF REPORTING ENTITY

SEC FILE NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

FIRM ID NO.

(No. and Street)

FOR PERIOD BEGINNING (MM/DD/YY)

(City)

(State/Province)

(Zip Code)

AND ENDING (MM/DD/YY)

(Country)

NAME OF PERSON TO CONTACT IN REGARD TO THIS REPORT EMAIL ADDRESS

(AREA CODE) TELEPHONE NO.

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT

OFFICIAL USE

Is this report consolidated or unconsolidated? Consolidated ☐ 198 Unconsolidated ☐ 199
Does respondent carry its own customer or security-based swap customer accounts? Yes ☐ 40 No ☐ 41
Check here if respondent is filing an audited report..... ☐ 42

EXECUTION: The registrant submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements, and schedules remain true, correct and complete as previously submitted.

Dated the _____ day of _____, 20____.

Signatures of:

Names of:

- 1) _____
Principal Executive Officer or Comparable Officer
- 2) _____
Principal Financial Officer or Comparable Officer
- 3) _____
Principal Operations Officer or Comparable Officer

- _____ 99
Principal Executive Officer or Comparable Officer
- _____ 99
Principal Executive Officer or Comparable Officer
- _____ 99
Principal Executive Officer or Comparable Officer

ATTENTION: Intentional misstatements and/or omissions of facts constitute federal criminal violations. (See 18 U.S.C. § 1001 and 15 U.S.C. § 78ff(a).)

Name of Firm: _____
As of: _____

FOCUS
Report
FORM SBS
Part 1

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

ASSETS

<u>Assets</u>	<u>Allowable</u>	<u>Non-Allowable</u>	<u>Total</u>
1. Cash.....	\$ 200		\$ 750
2. Cash segregated in compliance with federal and other regulations	\$ 210		\$ 760
3. Receivables from brokers/dealers and clearing organizations			
A. Failed to deliver			
1. Includible in the formula for reserve requirement under Rule 15c3-3a.....	\$ 220		
2. Includible in the formula for the deposit requirement under Rule 18a-4a.....	\$ 999		
3. Other.....	\$ 230		\$ 770
B. Securities borrowed			
1. Includible in the formula for reserve requirement under Rule 15c3-3a.....	\$ 240		
2. Includible in the formula for the deposit requirement under Rule 18a-4a.....	\$ 999		
3. Other.....	\$ 250		\$ 780
C. Omnibus accounts			
1. Includible in the formula for reserve requirement under Rule 15c3-3a.....	\$ 260		
2. Includible in the formula for the deposit requirement under Rule 18a-4a.....	\$ 999		
3. Other.....	\$ 270		\$ 790
D. Clearing organizations			
1. Includible in the formula for reserve requirement under Rule 15c3-3a.....	\$ 280		
2. Includible in the formula for the deposit requirement under Rule 18a-4a.....	\$ 999		
3. Other.....	\$ 290		\$ 800
E. Other.....	\$ 300	\$ 550	\$ 810
4. Receivables from customers			
A. Securities accounts			
1. Cash and fully secured accounts	\$ 310		
2. Partly secured accounts	\$ 320	\$ 560	
3. Unsecured accounts.....		\$ 570	
B. Commodity accounts.....	\$ 330	\$ 580	
C. Allowance for doubtful accounts.....	\$ () 335	\$ () 590	\$ 820
5. Receivables from non-customers			
A. Cash and fully secured accounts	\$ 340		
B. Partly secured and unsecured accounts	\$ 350	\$ 600	\$ 830
6. Securities purchased under agreements to resell.....	\$ 360	\$ 605	\$ 840
7. Trade date receivable.....	\$ 292		\$ 802
8. Total securities, including security-based swaps, and spot commodities and swaps owned at market value.....	\$ 849		\$ 850
Includes encumbered securities of: \$ 120			
9. Securities owned not readily marketable			
A. At cost.....	\$ 130	\$ 610	\$ 860
10. Other investments not readily marketable			
A. At cost.....	\$ 140		
B. At estimated fair value	\$ 450	\$ 620	\$ 870

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 1**

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBSB
Broker-Dealer SBSB
Stand-Alone MSBSP
Broker-Dealer MSBSP

<u>Assets</u>	<u>Allowable</u>	<u>Non-Allowable</u>	<u>Total</u>
11. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value			
A. Exempted securities \$	150		
B. Other..... \$	160	460	630
12. Secured demand notes – market value of collateral			
A. Exempted securities \$	170		
B. Other..... \$	180	470	650
13. Memberships in exchanges			
A. Owned, at market value..... \$	190		
B. Owned at cost.....		650	
C. Contributed for use of company, at market value		660	900
14. Investment in and receivables from affiliates, subsidiaries and associated partnerships.....	480	670	910
15. Property, furniture, equipment, leasehold improvements and rights under lease agreements			
At cost (net of accumulated depreciation and amortization).....	490	680	920
16. Other assets			
A. Dividends and interest receivable.....	500	690	
B. Free shipments.....	510	700	
C. Loans and advances.....	520	710	
D. Miscellaneous	530	720	
E. Collateral accepted under ASC 860	536		
F. SPE Assets.....	537		930
17. TOTAL ASSETS	540	740	940

Note: MSBSPs should only complete the Allowable and Total columns.

Name of Firm: _____

As of: _____

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBS
Broker-Dealer SBS
Stand-Alone MSBS
Broker-Dealer MSBS

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities	Non-A.I. Liabilities	Total
18. Bank loans payable			
A. Includible in the formula for reserve requirements under Rule 15c3-3a	\$ 1030	\$ 1240	\$ 1460
B. Includible in the formula for the deposit requirement under Rule 18a-4a	\$ 9999	\$ 9999	\$ 9999
C. Other	\$ 1040	\$ 1250	\$ 1470
19. Securities sold under repurchase agreements		\$ 1260	\$ 1480
20. Payable to brokers/dealers and clearing organizations			
A. Failed to receive			
1. Includible in the formula for reserve requirements under Rule 15c3-3a	\$ 1050	\$ 1270	\$ 1490
2. Includible in the formula for the deposit requirement under Rule 18a-4a	\$ 9999	\$ 9999	\$ 9999
3. Other	\$ 1060	\$ 1280	\$ 1500
B. Securities loaned			
1. Includible in the formula for reserve requirements under Rule 15c3-3a	\$ 1070		\$ 1510
2. Includible in the formula for the deposit requirement under Rule 18a-4a	\$ 9999		\$ 9999
3. Other	\$ 1080	\$ 1290	\$ 1520
C. Omnibus accounts			
1. Includible in the formula for reserve requirements under Rule 15c3-3a	\$ 1090		\$ 1530
2. Includible in the formula for the deposit requirement under Rule 18a-4a	\$ 9999		\$ 9999
3. Other	\$ 1095	\$ 1300	\$ 1540
D. Clearing organizations			
1. Includible in the formula for reserve requirements under Rule 15c3-3a	\$ 1100		\$ 1550
2. Includible in the formula for the deposit requirement under Rule 18a-4a	\$ 9999		\$ 9999
3. Other	\$ 1105	\$ 1310	\$ 1560
E. Other	\$ 1110	\$ 1320	\$ 1570
21. Payable to customers			
A. Securities accounts – including free credits of	\$ 950	\$ 1120	\$ 1580
B. Commodities accounts	\$ 1130	\$ 1330	\$ 1590
C. Security-based swap accounts – including free credits of	\$ 999	\$ 9999	\$ 9999
D. Swap accounts	\$ 9999	\$ 9999	\$ 9999
22. Payable to non-customers			
A. Securities accounts	\$ 1140	\$ 1340	\$ 1600
B. Commodities accounts	\$ 1150	\$ 1350	\$ 1610
C. Security-based swap accounts	\$ 9999	\$ 9999	\$ 9999
D. Swap accounts	\$ 9999	\$ 9999	\$ 9999
23. Other derivatives payables	\$ 9999	\$ 9999	\$ 1561
24. Trade date payable	\$ 9999	\$ 9999	\$ 1562
25. Securities sold but not yet purchased at market value – including arbitrage of	\$ 960	\$ 1360	\$ 1620
26. Accounts payable and accrued liabilities and expenses			
A. Drafts payable	\$ 1160		\$ 1630
B. Accounts payable	\$ 1170		\$ 1640
C. Income taxes payable	\$ 1180		\$ 1650
D. Deferred income taxes		\$ 1370	\$ 1660
E. Accrued expenses and other liabilities	\$ 1190		\$ 1670
F. Other	\$ 1200	\$ 1380	\$ 1680
G. Obligation to return securities	\$ 9999	\$ 9999	\$ 1686
H. SPE liabilities	\$ 9999	\$ 9999	\$ 1687

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBS
Broker-Dealer SBS
Stand-Alone MSBSP
Broker-Dealer MSBSP

27. Notes and mortgages payable

A. Unsecured	\$	<u>1210</u>		\$	<u>1690</u>	
B. Secured	\$	<u>1211</u>	\$	<u>1390</u>	\$	<u>1700</u>

28. Liabilities subordinated to claims of creditors

A. Cash borrowings.....			\$	<u>1400</u>	\$	<u>1710</u>
1. From outsiders	\$	<u>970</u>				
2. Includes equity subordination (Rule 15c3-1(d) or Rule 18a-1(h)) of	\$	<u>980</u>				
B. Securities borrowings, at market value			\$	<u>1410</u>	\$	<u>1720</u>
1. From outsiders	\$	<u>990</u>				
C. Pursuant to secured demand note collateral agreements			\$	<u>1420</u>	\$	<u>1730</u>
1. From outsiders	\$	<u>1000</u>				
2. Includes equity subordination (Rule 15c3-1(d) or Rule 18a-1(h)) of	\$	<u>1010</u>				
D. Exchange memberships contributed for use of company, at market value			\$	<u>1430</u>	\$	<u>1740</u>
E. Accounts and other borrowings not qualified for net capital purposes	\$	<u>1220</u>	\$	<u>1440</u>	\$	<u>1750</u>
29. TOTAL LIABILITIES	\$	<u>1230</u>	\$	<u>1450</u>	\$	<u>1760</u>

Ownership Equity

30. Sole proprietorship	\$	<u>1770</u>
31. Partnership and limited liability company - including limited partners	\$	<u>1780</u>
32. Corporation		
A. Preferred stock	\$	<u>1791</u>
B. Common stock	\$	<u>1792</u>
C. Additional paid-in capital	\$	<u>1793</u>
D. Retained earnings	\$	<u>1794</u>
E. Total	\$	<u>1795</u>
F. Less capital stock in treasury	\$	<u>1796</u>
33. TOTAL OWNERSHIP EQUITY (sum of Line Items 1770, 1780, 1795, and 1796)	\$	<u>1800</u>
34. TOTAL LIABILITIES AND OWNERSHIP EQUITY (sum of Line Items 1760 and 1810)	\$	<u>1810</u>

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 1

COMPUTATION OF NET CAPITAL (FILER AUTHORIZED TO USE MODELS)

Items on this page to be reported by a: Stand-Alone SBSB (Authorized to use models)
Broker-Dealer SBSB (Authorized to use models)
Broker-Dealer MSBSP (Authorized to use models)

Computation of Net Capital

1. Total ownership equity from Item 1800.....	\$	3480
2. Deduct ownership equity not allowable for net capital.....	\$ (	3490
3. Total ownership equity qualified for net capital.....	\$	3500
4. Add:		
A. Liabilities subordinated to claims of creditors allowable in computation of net capital.....	\$	3520
B. Other (deductions) or allowable credits (list).....	\$	3525
5. Total capital and allowable subordinated liabilities.....	\$	3530
6. Deductions and/or charges		
A. Total nonallowable assets from Statement of Financial Condition.....	\$	3540
1. Additional charges for customers' and non-customers' security accounts.....	\$	3550
2. Additional charges for customers' and non-customers' commodity accounts.....	\$	3560
3. Additional charges for customers' and non-customers' security-based swap accounts.....	\$	9999
4. Additional charges for customers' and non-customers' swap accounts.....	\$	9999
B. Aged fail-to-deliver.....	\$	3570
1. Number of items.....		3450
C. Aged short security differences - less		
reserve of.....	\$	3580
number of items.....		3470
D. Secured demand note deficiency.....	\$	3590
E. Commodity futures contracts and spot commodities - proprietary capital charges.....	\$	3600
F. Other deductions and/or charges.....	\$	3610
G. Deductions for accounts carried under Rules 15c3-1(a)(6) and (c)(2)(x).....	\$	3615
H. Total deductions and/or charges (sum of Lines 6A-6G).....	\$ (	3620
7. Other additions and/or allowable credits (list).....	\$	3630
8. Tentative net capital.....	\$	3640
9. Contractual securities commitments.....	\$	3660
10. Market risk exposure		
A. Total value at risk (sum of Lines 10A1-10A5).....	\$	3634
Value at risk components		
1. Fixed income VaR.....	\$	3636
2. Currency VaR.....	\$	3637
3. Commodities VaR.....	\$	3638
4. Equities VaR.....	\$	3639
5. Credit derivatives VaR.....	\$	3641
B. Diversification benefit.....	\$	3642
C. Total diversified VaR (Line 10A minus Line 10B).....	\$	3643
D. Multiplication factor.....	\$	3645
E. Subtotal (Line 10C multiplied by Line 10D).....	\$	3655

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 1

COMPUTATION OF NET CAPITAL (FILER AUTHORIZED TO USE MODELS)

Items on this page to be reported by a: Stand-Alone SBSD (Authorized to use models)
Broker-Dealer SBSD (Authorized to use models)
Broker-Dealer MSBSP (Authorized to use models)

11. Deduction for specific risk, unless included in Line 10 above	\$	3646
12. Risk deduction using scenario analysis	\$	3647
A. Fixed income	\$	3648
B. Currency	\$	3649
C. Commodities	\$	3651
D. Equities	\$	3652
E. Credit derivatives	\$	3653
13. Residual marketable securities (see Rule 15c3-1(c)(2)(vi) or 18a-1(c)(1)(vii), as applicable)	\$	3665
14. Total market risk exposure (add Lines 10E, 11, 12 and 13)	\$	3677
15. Credit risk exposure for commercial end user counterparties (see Appendix E to Rule 15c3-1 or Rule 18a-1(e)(2), as applicable)		
A. Counterparty exposure charge (add Lines 15A1 and 15A2)	\$	3676
1. Net replacement value default, bankruptcy	\$	9999
2. Credit equivalent amount exposure to the counterparty multiplied by the credit-risk weight of the counterparty multiplied by 8%	\$	9999
B. Concentration charge	\$	3659
1. Credit risk weight ≤20%	\$	3656
2. Credit risk weight >20% and ≤50%	\$	3657
3. Credit risk weight >50%	\$	3658
C. Portfolio concentration charge	\$	3678
16. Total credit risk exposure (add Lines 15A, 15B and 15C)	\$	3688
17. Net capital (subtract Lines 9, 14 and 16 from Line 8)	\$	3750

Name of Firm: _____
As of: _____

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Part 1**

COMPUTATION OF NET CAPITAL (FILER NOT AUTHORIZED TO USE MODELS)

Items on this page to be reported by a: Stand-Alone SBSB (Not authorized to use models)
Broker-Dealer SBSB (Not authorized to use models)
Broker-Dealer MSBSP (Not authorized to use models)

Computation of Net Capital

1. Total ownership equity from Item 1800.....	\$		3480
2. Deduct ownership equity not allowable for net capital.....	\$	(	3490
3. Total ownership equity qualified for net capital.....	\$		3500
4. Add:			
A. Liabilities subordinated to claims of creditors allowable in computation of net capital.....	\$		3520
B. Other (deductions) or allowable credits (list).....	\$		3529
5. Total capital and allowable subordinated liabilities.....	\$		3530
6. Deductions and/or charges			
A. Total nonallowable assets from Statement of Financial Condition.....	\$		3540
1. Additional charges for customers' and non-customers' security accounts.....	\$		3550
2. Additional charges for customers' and non-customers' commodity accounts.....	\$		3560
3. Additional charges for customers' and non-customers' security-based swap accounts.....	\$		9999
4. Additional charges for customers' and non-customers' swap accounts.....	\$		9999
B. Aged fail-to-deliver.....	\$		3570
1. Number of items.....			3450
C. Aged short security differences-less reserve of.....	\$		3460
1. Number of items.....			3470
D. Secured demand note deficiency.....	\$		3590
E. Commodity futures contracts and spot commodities - proprietary capital charges.....	\$		3600
F. Other deductions and/or charges.....	\$		3610
G. Deductions for accounts carried under Rule 15c3-1(a)(6) and (c)(2)(x).....	\$		3615
H. Total deductions and/or charges.....	\$	(	3620
7. Other additions and/or allowable credits.....	\$		3630
8. Tentative net capital (net capital before haircuts).....	\$		3640
9. Haircuts on securities other than security-based swaps			
A. Contractual securities commitments.....	\$		3660
B. Subordinated securities borrowings.....	\$		3670
C. Trading and investment securities			
1. Bankers' acceptances, certificates of deposit, commercial paper, and money market instruments.....	\$		3680
2. U.S. and Canadian government obligations.....	\$		3690
3. State and municipal government obligations.....	\$		3700
4. Corporate obligations.....	\$		3710
5. Stocks and warrants.....	\$		3720
6. Options.....	\$		3730
7. Arbitrage.....	\$		3732
8. Other securities.....	\$		3734
D. Undue concentration.....	\$		3650
E. Other (List:.....)	\$		3736
10. Haircuts on security-based swaps.....	\$		9999
11. Haircuts on swaps.....	\$		9999
12. Total haircuts.....	\$		3740
13. Net capital (Line 8 minus Line 12).....	\$		3750

Name of Firm: _____

As of: _____

Items on this page to be reported by a: Broker-Dealer SBSD
Broker-Dealer MSBSP

Calculation of Excess Tentative Net Capital (If Applicable)

1. Tentative net capital \$ 3640
2. Minimum tentative net capital requirement \$ 9999
3. Excess tentative net capital (difference between Lines 1 and 2) \$ 9999
4. Tentative net capital in excess of 120% of minimum tentative net capital requirement reported on Line 2 \$ 9999

Calculation of Minimum Net Capital Requirement

4. Ratio minimum net capital requirement
A. 6 2/3% of total aggregate indebtedness (Line Item 3840) \$ 3756
B. 2% of aggregate debit items as shown in the Formula for Reserve Requirements pursuant to Rule 15c3-3 \$ 3870
i. Minimum CFTC net capital requirement \$ 7490
C. 8% of risk margin amount \$ 9999
D. Minimum ratio requirement (sum of Lines 4A, 4B, and/or 4C, as applicable) \$ 9999
5. Fixed-dollar minimum net capital requirement \$ 3880
6. Minimum net capital requirement (greater of Lines 4D and 5) \$ 3760
7. Excess net capital (Item 3750 minus Item 3760) \$ 3910
8. Net capital and tentative net capital in relation to early warning thresholds
A. Net capital in excess of 120% of minimum net capital requirement reported on Line 6 \$ 9999
B. Net capital in excess of 5% of combined aggregate debit items as shown in the Formula for Reserve Requirements pursuant to Rule 15c3-3 \$ 9999

Computation of Aggregate Indebtedness

9. Total liabilities from Statement of Financial Condition (Item 1760) \$ 3790
10. Add:
A. Drafts for immediate credit \$ 3800
B. Market value of securities borrowed for which no equivalent value is paid or credited \$ 3810
C. Other unrecorded amounts (list) \$ 3820
D. Total additions (sum of Line Items 3800, 3810, and 3820) \$ 3830
11. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (see Rule 15c3-1(c)(1)(vii)) \$ 3838
12. Total aggregate indebtedness (sum of Line Items 3790 and 3830) \$ 3840
13. Percentage of aggregate indebtedness to net capital (Item 3840 divided by Item 3750) % 3850
14. Percentage of aggregate indebtedness to net capital after anticipated capital withdrawals (Item 3840 divided by Item 3750 less Item 4880) % 3853

Calculation of Other Ratios

15. Percentage of net capital to aggregate debits (Item 3750 divided by Item 4470) % 3851
16. Percentage of net capital, after anticipated capital withdrawals, to aggregate debits (Item 3750 less Item 4880, divided by Item 4470) \$ 3854
17. Percentage of debt to debt-to-equity total, computed in accordance with Rule 15c3-1(d) % 3860
18. Options deductions/net capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6) and (c)(2)(x) divided by net capital \$ 3852

Name of Firm: _____
As of: _____

Items on this page to be reported by a: Stand-Alone SBS

Calculation of Excess Tentative Net Capital (If Applicable)

1. Tentative net capital.....	\$	3640
2. Fixed-dollar minimum tentative net capital requirement.....	\$	9999
3. Excess tentative net capital (difference between Lines 1 and 2).....	\$	9999
4. Tentative net capital in excess of 120% of minimum tentative net capital requirements reported on Line 2.....	\$	9999

Calculation of Minimum Net Capital Requirement

5. Ratio minimum net capital requirement - 8% of risk margin amount.....	\$	9999
6. Fixed-dollar minimum net capital requirement.....	\$	3880
7. Minimum net capital requirement (greater of Lines 4 and 5).....	\$	3760
8. Excess net capital (Item 3750 minus Item 3760).....	\$	3910
9. Net capital in excess of 120% of minimum net capital requirement reported on Line 6 (Line Item 3750 - [Line Item 3760 x 120%]).....	\$	9999

Name of Firm: _____

As of: _____

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COMPUTATION OF TANGIBLE NET WORTH

Items on this page to be reported by a: Stand-Alone MSBSP
Broker-Dealer MSBSP

1. Total ownership equity (from Item 1800)	\$	1800
2. Goodwill and other intangible assets	\$	9999
3. Tangible net worth (Line 1 minus Line 2)	\$	9999

Name of Firm: _____
As of: _____

**FOCUS
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Part 1**

STATEMENT OF INCOME (LOSS)

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

REVENUE

**FOCUS Report
Reference Line**

1. Fees, Commissions, or Premiums from Derivatives, Securities and Other Instruments

A. Equities, ETFs and closed end funds \$ 13935
B. Exchange listed equity securities executed OTC \$ 13937
C. U.S. government and agencies \$ 11001
D. Foreign sovereign debt \$ 11002
E. Corporate debt \$ 11003
F. Mortgage-backed and other asset-backed securities \$ 11004
G. Municipals \$ 11005
H. Listed options \$ 13938
I. OTC options \$ 11006
J. All other securities commissions \$ 13939
K. Commodity transactions \$ 13991
L. Foreign exchange \$ 11007
M. Security-based swaps \$ 99999
N. Mixed swaps \$ 99999
O. Swaps \$ 99999

A: 3935
C/II: 3937

A: 3938

A: 3939
C: 3991, II/IIA: 3990

P. Aggregate amount if less than the greater of \$5,000 or 5% of total revenue
(Item 14030) (do not complete Lines 1A-1O) \$ 11008

1. Is any portion of Line 1P related to municipal securities? Yes ☐ No ☐ 11009

Total Commissions (sum of Lines 1A-1O): \$ 13940

A: 3940
A: 3970

Revenue from Sale of Investment Company Shares \$ 13970

Revenue from Sale of Insurance Based Products

A. Variable contracts \$ 11020
B. Non-securities insurance based products \$ 11021
C. Aggregate amount if less than the greater of \$5,000 or 5% of total revenue
(Item 14030) (do not complete Lines 3A-3B) \$ 11022

Total Revenue from Sale of Insurance Based Products (sum of Lines 3A-3B): \$ 11029

4. Gains or Losses on Derivative Trading Desks

A. Interest rate/fixed income products \$ 13921
B. Currency \$ 13922
C. Equity products \$ 13923
D. Commodity products \$ 13924
E. Other \$ 13925

C: 3921
C: 3922
C: 3923
C: 3924
C: 3925
C: 3926

Total Gains or Losses on Derivative Trading (sum of Lines 4A-4E): \$ 13926

5. Gains or Losses on Principal Trades (Do not report amounts already reported on Lines 4A-4E)

A. Equities, ETFs and closed end funds, Includes dividends: Yes ☐ No ☐ 11030 \$ 13903
B. U.S. government and agencies. Includes interest: Yes ☐ No ☐ 11031 \$ 11032
C. Foreign sovereign debt. Includes interest: Yes ☐ No ☐ 11033 \$ 11034
D. Corporate debt. Includes interest: Yes ☐ No ☐ 11035 \$ 11036
E. Mortgage-backed and other asset-backed securities. Includes interest: Yes ☐ No ☐ 11037 \$ 11038
F. Municipal securities. Includes interest: Yes ☐ No ☐ 11039 \$ 13901
G. Listed options \$ 11040
H. OTC options \$ 11041
I. Commodity transactions \$ 13904

C: 3903
C: 3901
C: 3901
C: 3901
C: 3901
C: 3901
C: 3904

Name of Firm: _____
As of: _____

**FOCUS
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FORM SBS
Part 1**

STATEMENT OF INCOME (LOSS)

Items on this page to be reported by a: Stand-Alone SBSB
Broker-Dealer SBSB
Stand-Alone MSBSP
Broker-Dealer MSBSP

J. Foreign exchange	\$	<u>13902</u>	C: 3902
K. Futures	\$	<u>11044</u>	
L. Security-based swaps (sum of Lines 5L1-5L4)	\$	<u>11042</u>	
1. Debt security-based swaps (other than credit default swaps)	\$	<u>99999</u>	
2. Equity security-based swaps	\$	<u>99999</u>	
3. Credit default security-based swaps	\$	<u>99999</u>	
4. Other security-based swaps	\$	<u>99999</u>	
M. Mixed swaps	\$	<u>99999</u>	
N. Swaps (sum of Lines 5N1-5N7)	\$	<u>11043</u>	
1. Interest rate swaps	\$	<u>99999</u>	
2. Foreign exchange swaps	\$	<u>99999</u>	
3. Commodity swaps	\$	<u>99999</u>	
4. Debt index swaps (other than credit default swaps)	\$	<u>99999</u>	
5. Equity index swaps	\$	<u>99999</u>	
6. Credit default swaps	\$	<u>99999</u>	
7. Other swaps	\$	<u>99999</u>	
O. Other	\$	<u>13951</u>	C: 3951
P. Aggregate amount if less than the greater of \$5,000 or 5% of total revenue (Item 14030) (do not complete Lines 5A-5O)	\$	<u>11045</u>	
1. Is any portion of Line 5P related to municipal securities?	Yes ☐ No ☐	<u>11046</u>	
Total Gains or Losses on Principal Trades (sum of Lines 5A-5O):		\$ <u>13950</u>	A: 3950
6. Capital Gains (Losses) on Firm Investment Accounts	\$	<u>13952</u>	A: 3952
A. Includes dividends and/or interest	Yes ☐ No ☐	<u>11053</u>	
B. Realized capital gains (losses)	\$	<u>4235</u>	C: 4235
C. Unrealized capital gains (losses)	\$	<u>4236</u>	C: 4236
7. Interest / Rebate / Dividend Income			
A. Securities borrowings	\$	<u>11060</u>	
B. Reverse repurchase transactions	\$	<u>11061</u>	
C. Margin interest	\$	<u>13960</u>	C/II: 3960
D. Revenue earned from customer bank sweep (FDIC insured products) programs	\$	<u>11062</u>	
E. Revenue earned from customer fund sweeps into '40 Act investments	\$	<u>11063</u>	
F. Interest and/or dividends on securities held in firm inventory (not otherwise reported)	\$	<u>11064</u>	
G. Other interest	\$	<u>13953</u>	C: 3953
H. Aggregate amount if less than the greater of \$5,000 or 5% of total revenue (Item 14030) (do not complete Lines 7A-7G)	\$	<u>11065</u>	
Total Interest / Rebate / Dividend Income (sum of Lines 7A-7G):		\$ <u>11069</u>	
8. Revenue from Underwritings and Selling Group Participation			
A. Municipal offerings	\$	<u>11070</u>	
B. Registered offerings			
1. Offerings other than self or affiliate (excludes municipal offerings)	\$	<u>11071</u>	
2. Offerings, self or affiliate (excludes municipal offerings)	\$	<u>11072</u>	
Total Revenue from Registered Offerings (sum of Lines 8A-8B2):		\$ <u>11079</u>	
C. Unregistered offerings (excludes municipal offerings) (sections below refer to Operational Page – see instructions)			
Did the broker or dealer filing this report participate in the sale of any unregistered offering during the reporting period for which it received no compensation?			
Yes ☐ No ☐ <u>11080</u>			
1. Unregistered offerings, other than self or affiliate offerings – Section 1	\$	<u>11081</u>	
2. Unregistered offerings, self or affiliate offerings – Section 2	\$	<u>11082</u>	
Total Revenue from Unregistered Offerings (sum of Line Items 11081 and 11082):		\$ <u>11089</u>	

Name of Firm: _____

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FORM SBS
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STATEMENT OF INCOME (LOSS)

Items on this page to be reported by a: Stand-Alone SBSB
Broker-Dealer SBSB
Stand-Alone MSBSP
Broker-Dealer MSBSP

Total Revenue from Underwritings and Selling Group Participation (sum of Line Items 11070, 11079, and 11089): \$ 13955 A: 3955

9. Miscellaneous Fees Earned

A. Fees earned from affiliated entities.....	\$	11090	
B. Investment banking fees; M&A advisory.....	\$	11091	
C. Account supervision and investment advisory services.....	\$	13975	A: 3975
D. Administrative fees.....	\$	11092	A: 3975
E. Revenue from research services.....	\$	13980	C/II: 3980
F. Rebates from exchanges, ECNs, and ATSS.....	\$	11093	
G. 12b-1 fees.....	\$	11094	
H. Mutual fund revenue other than concessions or 12b-1 fees.....	\$	11095	
I. Execution services.....	\$	11096	
J. Clearing services.....	\$	11097	
K. Fees earned on customer bank sweep (FDIC insured products) programs.....	\$	11098	
L. Fees earned from sweep programs into '40 Act investments.....	\$	11099	
M. Networking fees from '40 Act companies.....	\$	11100	
N. Other fees.....	\$	11101	
O. Aggregate amount if less than the greater of \$5,000 or 5% of total revenue (Item 14030) (do not complete Lines 9A-9N).....	\$	11102	
Total Fees Earned (sum of Lines 9A-9N):		\$ 11109	

10. Other Revenue

A. Total revenue from sale of certificates of deposit (CDs) issued by an affiliate.....	\$	11126	
B. Other revenue.....	\$	13995	A: 3995

If Line Item 13995 is greater than both 10% of Item 14030 and \$5,000, provide a description of the 3 largest components of Other Revenue, along with the associated revenue for each.

B-1. Description of: 1st largest component of Other Revenue			
	11120	\$	11121
B-2. Description of: 2nd largest component of Other Revenue			
	11122	\$	11123
B-3. Description of: 3rd largest component of Other Revenue			
	11124	\$	11125

Total Revenue (sum of Line Items 11230, 11231, 11232, 11233, 11234, 11235, & 11236): \$ 14030 A: 4030

EXPENSES

11. Compensation Expenses

A. Registered representatives' compensation.....	\$	14110	C/II: 4110
B. Compensation paid to all other revenue producing personnel (including temporary personnel).....	\$	14040	C/II: 4040
C. Compensation paid to non-revenue producing personnel (including temporary personnel).....	\$	11200	
D. Bonuses.....	\$	11201	
E. Other compensation expenses.....	\$	11202	
F. Aggregate amount if less than the greater of \$5,000 or 5% of total expenses (Item 14200) (do not complete Lines 11A-11E).....	\$	11203	
Total Compensation Expenses (sum of Lines 11A-11E):		\$ 11209	

12. Commission, Clearance and Custodial Expenses

A. Floor brokerage and fees paid.....	\$	14055	C/II: 4055
B. Amounts paid to exchanges, ECNs, and ATSS.....	\$	14145	C/II: 4145
C. Clearance fees paid to broker-dealers.....	\$	11210	
D. Clearance fees paid to non-broker-dealers.....	\$	14135	C/II: 4135
E. Commission paid to broker-dealers.....	\$	14140	IIA: 4140
F. 12b-1 fees.....	\$	11211	
G. Custodial fees.....	\$	11212	

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

STATEMENT OF INCOME (LOSS)

Items on this page to be reported by a: Stand-Alone SBSB
Broker-Dealer SBSB
Stand-Alone MSBSP
Broker-Dealer MSBSP

H. Aggregate amount if less than the greater of \$5,000 or 5% of total expenses (Item 14200) (do not complete Lines 12A-12G)	\$	11213	
Total Commission, Clearance and Custodial Fees (sum of Lines 12A-12G): \$		11219	
13. Expenses Incurred on Behalf of Affiliates and Others			
A. Soft dollar expenses	\$	11220	
B. Rebates/recapture of commissions	\$	11221	
Total Expenses incurred on Behalf of Affiliates and Others (sum of Lines 13A-13B): \$		11229	
14. Interest and Dividend Expenses			
A. Interest paid on bank loans	\$	11230	
B. Interest paid on debt instruments where firm is the obligor, including subordination agreements	\$	11231	
C. Interest paid on customer and security-based swap customer balances	\$	11232	
D. Interest paid on securities loaned transactions	\$	11233	
E. Interest paid on repurchase agreements	\$	11234	
F. Interest and/or dividends on short securities inventory	\$	11235	
G. Other interest expenses	\$	11236	
H. Aggregate amount if less than the greater of \$5,000 or 5% of total expenses (Item 14200) (do not complete Lines 14A-14G)	\$	11237	
Total Interest and Dividend Expenses (sum of Lines 14A-14G): \$		14075	A: 4075
15. Fees Paid to Third Party Service Providers			
A. To affiliates	\$	11240	
B. To non-affiliates	\$	11241	
Total Fees Paid to Third Party Service Providers (sum of Lines 15A-15B): \$		11249	
16. General, Administrative, Regulatory and Miscellaneous Expenses			
A. Finders' fees	\$	11250	
B. Technology, data and communication costs	\$	14060	C/II: 4060, 4186
C. Research	\$	11251	
D. Promotional fees	\$	14150	C/II: 4150
E. Travel and entertainment	\$	11252	
F. Occupancy and equipment expenses	\$	14080	C/II: 4080
G. Non-recurring charges	\$	14190	C/II: 4190
H. Regulatory fees	\$	14195	A: 4195
I. Professional service fees	\$	11253	
J. Litigation, arbitration, settlement, restitution and rescission, and related outside counsel legal fees	\$	11254	
K. Losses in error accounts and bad debts	\$	14170	C/II: 4170
L. State and local income taxes	\$	11255	
M. Aggregate amount if less than the greater of \$5,000 or 5% of total expenses (Item 14200) (do not complete Lines 16A-16L)	\$	11256	
Total General, Administrative, Regulatory and Miscellaneous Expenses (sum of Lines 16A-16L): \$		11269	
17. Other Expenses			
A. Other expenses	\$	14100	A: 4100
If Line Item 14100 is greater than both 10% of Item 14200 and \$5,000, provide a description of the 3 largest components of Other Expenses, along with the associated expense for each.			
A-1. Description of: 1st largest component of Other Expenses			
	11280	\$	11281
A-2. Description of: 2nd largest component of Other Expenses			
	11282	\$	11283
A-3. Description of: 3rd largest component of Other Expenses			
	11284	\$	11285
Total Expenses (sum of Line Items 11209, 11219, 11229, 14075, 11249, 11269, and 14100): \$		14200	A: 4200

Name of Firm: _____
As of: _____

FOCUS
Report
FORM SBS
Part 1

STATEMENT OF INCOME (LOSS)

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

NET INCOME

18. Net Income

A. Income (loss) before Federal income taxes and items below	\$	<u>14210</u>	A: 4210
B. Provision for Federal income taxes.....	\$	<u>14220</u>	A: 4220
C. Equity in earnings (losses) of unconsolidated subsidiaries not included above	\$	<u>14222</u>	A: 4222
1. After Federal income taxes of.....	\$	<u>4238</u>	C/II: 4238
D. Extraordinary gains (losses)	\$	<u>14224</u>	A: 4224
1. After Federal income taxes of.....	\$	<u>4239</u>	C/II: 4239
E. Cumulative effect of changes in accounting principles.....	\$	<u>14225</u>	A: 4225
F. Net income (loss) after Federal income taxes and extraordinary items	\$	<u>14230</u>	A: 4230
Total Net Income (Line Item 14210 minus Line Items 14220, 14222, 14224, and 14225):		\$	<u>11299</u>

Name of Firm: _____

As of: _____

Items on this page to be reported by a: Stand-Alone SBS
Broker-Dealer SBS
Broker-Dealer MSBS

OWNERSHIP EQUITY AND SUBORDINATED LIABILITIES MATURING OR PROPOSED TO BE WITHDRAWN WITHIN THE NEXT SIX MONTHS AND ACCRUALS, WHICH HAVE NOT BEEN DEDUCTED IN THE COMPUTATION OF NET CAPITAL

Type of Proposed Withdrawal or Accrual (See below for code to enter)	Name of Lender or Contributor	Insider or Outsider? (In or Out)	Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)	(MM/DD/YY) Withdrawal or Maturity Date	Expect to Renew (Yes or No)
4600	4601	4602	\$ 4603	4604	4605
4610	4611	4612	\$ 4613	4614	4615
4620	4621	4622	\$ 4623	4624	4625
4630	4631	4632	\$ 4633	4634	4635
4640	4641	4642	\$ 4643	4644	4645
4650	4651	4652	\$ 4653	4654	4655
4660	4661	4662	\$ 4663	4664	4665
4670	4671	4672	\$ 4673	4674	4675
4680	4681	4682	\$ 4683	4684	4685
4690	4691	4692	\$ 4693	4694	4695
			Total: \$ 4699*		

* To agree with the total on Recap (Line Item 4880)

Instructions: Detailed listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation, which could be required by the lender on demand or in less than six months.

CODE:

- 1.
- 2.
- 3.
- 4.

DESCRIPTIONS:

Equity capital
Subordinated liabilities
Accruals
Assets not readily convertible into cash

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 1**

**CAPITAL WITHDRAWALS
RECAP**

Items on this page to be reported by a: Stand-Alone SBS
Broker-Dealer SBS
Broker-Dealer MSBS

**OWNERSHIP EQUITY AND SUBORDINATED LIABILITIES MATURING OR PROPOSED TO BE WITHDRAWN WITHIN THE NEXT SIX MONTHS
AND ACCRUALS, WHICH HAVE NOT BEEN DEDUCTED IN THE COMPUTATION OF NET CAPITAL**

1. Equity capital

A. Partnership and limited liability company capital

1. General partners.....	\$	4700
2. Limited partners and limited liability company members	\$	4710
3. Undistributed profits.....	\$	4720
4. Other (describe below).....	\$	4730
5. Sole proprietorship.....	\$	4735

B. Corporation capital

1. Common stock.....	\$	4740
2. Preferred stock	\$	4750
3. Retained earnings (dividends and other)	\$	4760
4. Other (describe below).....	\$	4770

2. Subordinated liabilities

A. Secured demand notes.....	\$	4780
B. Cash subordinates	\$	4790
C. Debentures.....	\$	4800
D. Other (describe below).....	\$	4810

3. Other accrued withdrawals

A. Bonuses	\$	4820
B. Voluntary contributions to pension or profit sharing plans.....	\$	4860
C. Other (describe below).....	\$	4870

Total (sum of Lines 1-3): \$ 4880

4. Description of Other

**STATEMENT OF CHANGES IN OWNERSHIP EQUITY
(SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)**

1. Balance, beginning of period	\$	4240		
A. Net income (loss)	\$	4250		
B. Additions (includes non-conforming capital of	\$	4262	\$	4260
C. Deductions (includes non-conforming capital of	\$	4272	\$	4270
2. Balance, end of period (from Line Item 1800)	\$	4290		

**STATEMENT OF CHANGES IN LIABILITIES
SUBORDINATED TO CLAIMS OF CREDITORS**

3. Balance, beginning of period	\$	4300
A. Increases.....	\$	4310
B. Decreases	\$	4320
4. Balance, end of period (from Item 3520)	\$	4330

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

FINANCIAL AND OPERATIONAL DATA

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Broker-Dealer MSBSP

	<u>Valuation</u>	<u>Number</u>
1. Month end total number of stock record breaks		
A. Breaks long unresolved for more than three business days.....	\$ <u>4890</u>	<u>4900</u>
B. Breaks short unresolved for more than seven business days after discovery	\$ <u>4910</u>	<u>4920</u>
2. Is the firm in compliance with Rule 17a-13 or 18a-9, as applicable, regarding periodic count and verification of securities positions and locations at least once in each calendar quarter? (Check one).....	Yes ☐ <u>4930</u>	No ☐ <u>4940</u>
3. Personnel employed at end of reporting period		
A. Income producing personnel.....		<u>4950</u>
B. Non-income producing personnel (all other).....		<u>4960</u>
C. Total (sum of Lines 3A-3B)		<u>4970</u>
4. Actual number of tickets executed during the reporting period.....		<u>4980</u>
5. Number of corrected customer confirmations mailed after settlement date		<u>4990</u>
	<u>No. of Items</u>	<u>Ledger Amount</u>
6. Failed to deliver 5 business days or longer (21 business days or longer in the case of municipal securities)	<u>5360</u>	\$ <u>5361</u>
7. Failed to receive 5 business days or longer (21 business days or longer in the case of municipal securities)	<u>5363</u>	\$ <u>5364</u>
8. Security (including security-based swap) concentrations		<u>Market Value</u>
A. Proprietary positions for which there is an undue concentration.....		\$ <u>5370</u>
B. Customers' and security-based swap customers' accounts under Rules 15c3-3 or 18a-4, as applicable.....		\$ <u>5374</u>
9. Total of personal capital borrowings due within six months.....		\$ <u>5378</u>
10. Maximum haircuts on underwriting commitments during the reporting period		\$ <u>5380</u>
11. Planned capital expenditures for business expansion during next six months.....		\$ <u>5382</u>
12. Liabilities of other individuals or organizations guaranteed by respondent		\$ <u>5384</u>
13. Lease and rentals payable within one year		\$ <u>5386</u>
14. Aggregate lease and rental commitments payable for entire term of the lease		
A. Gross		\$ <u>5388</u>
B. Net		\$ <u>5390</u>

Name of Firm: _____
As of: _____

FOCUS
Report
FORM SBS
Part 1

FINANCIAL AND OPERATIONAL DATA

Items on this page to be reported by a: Stand-Alone SBSB
Broker-Dealer SBSB
Broker-Dealer MSBSP

Operational Deductions from Capital - Note A

	I No. of Items	II Debits (Short Value) (Omit 000's)	III Credits (Long Value) (Omit 000's)	IV Deductions in Computing Net Capital (Omit Pennies)
1. Money suspense and balancing differences	5610	\$ 5810	\$ 6010	\$ 6012
2. Security suspense and differences with related money balances	L 5620	\$ 5820	\$ 6020	\$ 6022
	S 5625	\$ 5825	\$ 6025	\$ 6027
3. Market value of short and long security suspense and differences without related money balances (other than reported in Line 4, below)	5630	\$ 5830	\$ 6030	\$ 6032
4. Market value of security record breaks	5640	\$ 5840	\$ 6040	\$ 6042
5. Unresolved reconciling differences with others				
A. Correspondents, SBSBs, and MSBSPs	L 5650	\$ 5850	\$ 6050	\$ 6052
	S 5655	\$ 5855	\$ 6055	\$ 6057
B. Depositories	5660	\$ 5860	\$ 6060	\$ 6062
C. Clearing organizations	L 5670	\$ 5870	\$ 6070	\$ 6072
	S 5675	\$ 5875	\$ 6075	\$ 6077
D. Inter-company accounts	5680	\$ 5880	\$ 6080	\$ 6082
E. Bank accounts and loans	5690	\$ 5890	\$ 6090	\$ 6092
F. Other	5700	\$ 5900	\$ 6100	\$ 6102
G. (Offsetting) Lines 5A through 5F	5720	\$ 5920	\$ 6120	
TOTAL (Lines 5A-5G)	5730	\$ 5930	\$ 6130	\$ 6132
6. Commodity differences	5740	\$ 5940	\$ 6140	\$ 6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified	5760	\$ 5960	\$ 6160	\$ 6162
8. TOTAL (Lines 1-7)	5770	\$ 5970	\$ 6170	\$ 6172
9. Lines 1-6 resolved subsequent to report date	5775	\$ 5975	\$ 6175	\$ 6177
10. Aged fails - to deliver	5780	\$ 5980	\$ 6180	\$ 6182
- to receive	5785	\$ 5985	\$ 6185	\$ 6187

NOTE A - This section must be completed as follows:

- The filers must complete Column IV, Lines 1 through 8 and 10, reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
- Columns I, II and III of Lines 1 through 8 must be completed only if the total deduction on Column IV of Line 8 equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of Line 10 require completion.
- A response to Columns I through IV of Line 9 and the "Potential Operational Charges Not Deducted From Capital-Note B" schedule are required only if:
 - The parameters cited in Note A-2 exist, and
 - The total deduction, Line 8, Column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
- All columns and Lines 1 through 10 must be answered if required. If respondent has nothing to report, enter "0."

Other Operational Data (Items 1, 2 and 3 below require an answer)

Item 1. Have the accounts enumerated on Lines 5A through 5F above been reconciled with statements received from others within 35 days for Lines 5A through 5D and 65 days for Lines 5E and 5F prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes _____ 5600
No _____ 5601

Item 2. Do the respondent's books reflect a concentrated position in commodities? If yes, report the totals (\$000 omitted) in accordance with the specific instructions. If No, answer "0" for:

A. Firm trading and investment accounts \$ _____ 5602

B. Customers' and non-customers' and other accounts \$ _____ 5603

Item 3. Does respondent have any planned operational changes? (Answer Yes or No based on specific instructions.) Yes _____ 5604

No _____ 5605

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

FINANCIAL AND OPERATIONAL DATA

Items on this page to be reported by a: Stand-Alone SBS
Broker-Dealer SBS
Broker-Dealer MSBS

Potential Operational Charges Not Deducted from Capital - Note B

	I No. of Items	II Debits (Short Value) (Report in Thousands)	III Credits (Long Value) (Report in Thousands)	IV Deductions in Computing Net Capital (Omit Pennies)
1. Money suspense and balancing differences	6210	\$ 6410	\$ 6610	\$ 6612
2. Security suspense and differences with related money balances.....	L 6220	\$ 6420	\$ 6620	\$ 6622
	S 6225	\$ 6425	\$ 6625	\$ 6627
3. Market value of short and long security suspense and differences without related money (other than reported in Line 4, below).....	6230	\$ 6430	\$ 6630	\$ 6632
4. Market value of security record breaks.....	6240	\$ 6440	\$ 6640	\$ 6642
5. Unresolved reconciling differences with others				
A. Correspondents, SBSs, and MSBSs.....	L 6250	\$ 6450	\$ 6650	\$ 6652
	S 6255	\$ 6455	\$ 6655	\$ 6657
B. Depositories.....	6260	\$ 6460	\$ 6660	\$ 6662
C. Clearing organizations.....	L 6270	\$ 6470	\$ 6670	\$ 6672
	S 6275	\$ 6475	\$ 6675	\$ 6677
D. Inter-company accounts.....	6280	\$ 6480	\$ 6680	\$ 6682
E. Bank accounts and loans.....	6290	\$ 6490	\$ 6690	\$ 6692
F. Other.....	6300	\$ 6500	\$ 6700	\$ 6702
G. (Offsetting) Lines 5A through 5F.....	6310	\$ 6510	\$ 6710	
TOTAL (Lines 5A-5G).....	6330	\$ 6530	\$ 6730	\$ 6732
6. Commodity differences	6340	\$ 6540	\$ 6740	\$ 6742
7. TOTAL (Lines 1-6)	6370	\$ 6570	\$ 6770	\$ 6772

NOTE B - This section must be completed as follows:

- Lines 1 through 6 and Columns I through IV must be completed only if:
 - The total deductions on Line 8, Column IV, of the "Operational Deductions From Capital-Note A" schedule equal or exceed 25% of excess net capital as of the prior month end reporting date; and
 - The total deduction on Line 8, Column IV, of the "Operational Deductions From Capital-Note A" schedule for the current month exceeds the total deductions for the prior month by 50% or more. If respondent has nothing to report, enter "0."
- Include only suspense and difference items open at the report date which were NOT required to be deducted in the computation of net capital AND which were not resolved seven (7) business days subsequent to the report date.
- Include in Column IV only additional deductions not comprehended in the computation of net capital at the report date.
- Include on Lines 5A through 5F unfavorable differences offset by favorable differences at the report date if resolution of the favorable items resulted in additional deductions in the computation of net capital subsequent to the report date.
- Exclude from Lines 5A through 5F new reconciling differences disclosed as a result of reconciling with the books of account statements received subsequent to the report date.
- Lines 1 through 5 above correspond to similar lines in the "Operational Deductions From Capital-Note A" schedule and the same instructions should be followed except as stated in Notes B-1 through B-5 above.

Name of Firm: _____
As of: _____

**FOCUS
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Part 1**

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
(See Rule 15c3-3, Exhibit A and Related Notes)

Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3)
Broker-Dealer MSBSP (if subject to Rule 15c3-3)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A)..... \$ 4340
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B) \$ 4350
3. Monies payable against customers' securities loaned (see Note C) \$ 4360
4. Customers' securities failed to receive (see Note D) \$ 4370
5. Credit balances in firm accounts which are attributable to principal sales to customers..... \$ 4380
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days \$ 4390
7. **Market value of short security count differences over 30 calendar days old \$ 4400
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days \$ 4410
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days \$ 4420
10. Other (List: _____) \$ 4425
11. TOTAL CREDITS (sum of Lines 1-10)..... \$ 4430

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts, excluding unsecured accounts and accounts doubtful of collection (see Note E)..... \$ 4440
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver \$ 4450
14. Failed to deliver of customers' securities not older than 30 calendar days \$ 4460
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (see Note F) \$ 4465
- Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in customer accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (see Note G)..... \$ 4467
17. Other (List: _____) \$ 4469
18. **Aggregate debit items (sum of Lines 12-17) \$ 4470
19. **Less 3% (for alternative method only - see Rule 15c3-1(a)(1)(ii)) (3% x Line Item 4470)..... \$ 4471
20. **TOTAL 15c3-3 DEBITS (Line 18 less Line 19) \$ 4472

RESERVE COMPUTATION

21. Excess of total debits over total credits (Line 20 less Line 11) \$ 4480
22. Excess of total credits over total debits (Line 11 less Line 20)..... \$ 4490
23. If computation is made monthly as permitted, enter 105% of excess of total credits over total debits \$ 4500
24. Amount held on deposit in "Reserve Bank Account(s)," including \$ 4505 value of qualified securities, at end of reporting period \$ 4510
25. Amount of deposit (or withdrawal) including \$ 4515 value of qualified securities \$ 4520
26. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including \$ 4525 value of qualified securities \$ 4530
27. Date of deposit (MM/DD/YY)..... \$ 4540

FREQUENCY OF COMPUTATION

28. Daily 4332 Weekly 4333 Monthly 4334

** In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 15c3-3

Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3)
Broker-Dealer MSBSP (if subject to Rule 15c3-3)

State the market valuation and number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B..... \$ **4586**
A. Number of items **4587**
2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D \$ **4588**
A. Number of items **4589**
3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3..... Yes **4584** No **4585**

Notes:

- A – Do not include in Line 1 customers' fully paid and excess margin securities required by Rule 15c3-3, to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.
- B – State separately in response to Lines 1 and 2 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.
- C – Be sure to include in Line 2 only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.
- D – Line 2 must be responded to only with a report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to Line 2 should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 1**

COMPUTATION FOR DETERMINATION OF PAB REQUIREMENTS

Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3)
Broker-Dealer MSBSP (if subject to Rule 15c3-3)

CREDIT BALANCES

1. Free credit balances and other credit balances in PAB security accounts (see Note A).....	\$	2110
2. Monies borrowed collateralized by securities carried for the accounts of PAB (see Note B).....	\$	2120
3. Monies payable against PAB securities loaned (see Note C).....	\$	2130
4. PAB securities failed to receive (see Note D).....	\$	2140
5. Credit balances in firm accounts which are attributable to principal sales to PAB.....	\$	2150
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	\$	2152
7. **Market value of short security count differences over 30 calendar days old.....	\$	2154
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	\$	2156
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	\$	2158
10. Other (List: _____).....	\$	2160
11. TOTAL PAB CREDITS (sum of Lines 1-10)	\$	2170

DEBIT BALANCES

12. Debit balances in PAB cash and margin accounts, excluding unsecured accounts and accounts doubtful of collection (see Note E)	\$	2180
13. Securities borrowed to effectuate short sales by PAB and securities borrowed to make delivery on PAB securities failed to deliver	\$	2190
14. Failed to deliver of PAB securities not older than 30 calendar days	\$	2200
15. Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in PAB accounts (see Note F)	\$	2210
16. Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in PAB accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (see Note G)	\$	2215
17. Other (List: _____)	\$	2220
18. TOTAL PAB DEBITS (sum of Lines 12-17)	\$	2230

RESERVE COMPUTATION

19. Excess of total PAB debits over total PAB credits (Line 18 less Line 11).....	\$	2240
20. Excess of total PAB credits over total PAB debits (Line 11 less Line 18).....	\$	2250
21. Excess debits in customer reserve formula computation	\$	2260
22. PAB reserve requirement (Line 20 less Line 21).....	\$	2270
23. Amount held on deposit in Reserve Bank Account(s) including \$ 2275 value of qualified securities, at end of reporting period	\$	2280
24. Amount of deposit (or withdrawal) including \$ 2285 value of qualified securities	\$	2290
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including \$ 2295 value of qualified securities.....	\$	2300
26. Date of deposit (MM/DD/YY)		2310

FREQUENCY OF COMPUTATION

27. Daily 2315 Weekly 2320 Monthly 2330

* See notes regarding PAB Reserve Bank Account Computation (Notes 1-10).

In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: _____

As of: _____

Items on this page to be reported by a: Broker-Dealer SBSD (if claiming an exemption from Rule 15c3-3)
Broker-Dealer MSBSP (if claiming an exemption from Rule 15c3-3)

EXEMPTIVE PROVISION UNDER RULE 15c3-3

If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only):

- A. (k)(1) – \$2,500 capital category as per Rule 15c3-3 4550
- B. (k)(2)(A) – "Special Account for the Exclusive Benefit of Customers" maintained 4560
- C. (k)(2)(B) – All customer transactions cleared through another broker-dealer on a fully disclosed basis
Name of clearing firm: 4335 4570
- D. (k)(3) – Exempted by order of the Commission (include copy of letter) 4580

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 1**

**COMPUTATION FOR DETERMINATION OF THE AMOUNT TO BE MAINTAINED IN THE SPECIAL ACCOUNT
FOR THE EXCLUSIVE BENEFIT OF SECURITY-BASED SWAP CUSTOMERS – RULE 18a-4, APPENDIX A**

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD

CREDIT BALANCES

1. Free credit balances and other credit balances in the accounts carried for security-based swap customers.....	\$	9999
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (see Note B).....	\$	9999
3. Monies payable against security-based swap customers' securities loaned (see Note C).....	\$	9999
4. Security-based swap customers' securities failed to receive (see Note D).....	\$	9999
5. Credit balances in firm accounts attributable to principal sales to security-based swap customers.....	\$	9999
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days.....	\$	9999
7. **Market value of short security count differences over 30 calendar days old.....	\$	9999
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days.....	\$	9999
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days.....	\$	9999
10. Other (List:).....	\$	9999
11. TOTAL CREDITS (sum of Lines 1-10).....	\$	9999

DEBIT BALANCES

12. Debit balances in accounts carried for security-based swap customers, excluding unsecured accounts and accounts doubtful of collection (see Note E).....	\$	9999
13. Securities borrowed to effectuate short sales by security-based swap customers and securities borrowed to make delivery on security-based swap customers' securities failed to deliver.....	\$	9999
14. Failed to deliver of security-based swap customers' securities not older than 30 calendar days.....	\$	9999
Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in accounts carried for security-based swap customers (see Note F).....	\$	9999
16. Margin related to security future products written, purchased or sold in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivative clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) (see Note G).....	\$	9999
17. Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q-1).....	\$	9999
18. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer.....	\$	9999
19. Other (List:).....	\$	9999
20. **Aggregate debit items.....	\$	9999
21. **TOTAL 18a-4a DEBITS (sum of Lines 12-19).....	\$	9999

RESERVE COMPUTATION

22. Excess of total debits over total credits (Line 21 less Line 11).....	\$	9999
23. Excess of total credits over total debits (Line 11 less Line 21).....	\$	9999
24. Amount held on deposit in "Reserve Bank Account(s)," including value of qualified securities, at end of reporting period.....	\$	9999
25. Amount of deposit (or withdrawal) including \$ 9999 value of qualified securities.....	\$	9999
26. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including \$ 9999 value of qualified securities.....	\$	9999
27. Date of deposit (MM/DD/YY).....	\$	9999

** In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: _____

As of: _____

INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 18a-4

State the market valuation and number of items of:

- | | | | | |
|----|--|-----|-------|------|
| 1. | Security-based swap customers' excess securities collateral not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frame specified under Rule 18a-4. Notes A and B..... | \$ | _____ | 9999 |
| | A. Number of items | | _____ | 9999 |
| 2. | Security-based swap customers' excess securities collateral for which instructions to reduce possession or control had not been issued as of the report date under Rule 18a-4. | \$ | _____ | 9999 |
| | A. Number of items | | _____ | 9999 |
| 3. | The system and procedures utilized in complying with the requirement to maintain physical possession or control of security-based swap customers' excess securities collateral have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 18a-4. | Yes | _____ | 9999 |
| | | No | _____ | 9999 |

B – State separately in response to Line 1 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

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**FOCUS
Report
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Part 2**

BALANCE SHEET (INFORMATION AS REPORTED ON FFIEC FORM 031 - SCHEDULE RC)

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

<u>Assets</u>	<u>Totals</u>
1. Cash and balances due from depository institutions (from FFIEC Form 031's Schedule RC-A)	
A. Noninterest-bearing balances and currency and coin.....	\$ 0081b
B. Interest-bearing balances	\$ 0071b
2. Securities	
A. Held-to-maturity securities	\$ 1754b
B. Available-for-sale securities	\$ 1773b
3. Federal funds sold and securities purchased under agreements to resell	
A. Federal funds sold in domestic offices	\$ 8987b
B. Securities purchased under agreements to resell	\$ 8989b
4. Loans and lease financing receivables (from FFIEC Form 031's Schedule RC-C)	
A. Loans and leases held for sale.....	\$ 5369b
B. Loans and leases, net of unearned income	\$ 8528b
C. LESS: Allowance for loan and lease losses	\$ 3123b
D. Loans and leases, net of unearned income and allowance (Line 4B minus Line 4C).....	\$ 8529b
5. Trading assets (from FFIEC Form 031's Schedule RC-D).....	\$ 3545b
6. Premises and fixed assets (including capitalized leases).....	\$ 2145b
7. Other real estate owned (from FFIEC Form 031's Schedule RC-M)	\$ 2150b
8. Investment in unconsolidated subsidiaries and associated companies	\$ 2130b
Direct and indirect investments in real estate ventures	\$ 3656b
10. Intangible assets	
A. Goodwill	\$ 3163b
B. Other intangible assets (from FFIEC Form 031's Schedule RC-M).....	\$ 0426b
11. Other assets (from FFIEC Form 031's Schedule RC-F).....	\$ 2160b
12. Total assets (sum of Lines 1 through 11)	\$ 2170b

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 2**

BALANCE SHEET (INFORMATION AS REPORTED ON FFIEC FORM 031 – SCHEDULE RC)

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

Liabilities	Totals
13. Deposits	
A. In domestic offices (sum of totals of Columns A and C from FFIEC Form 031's Schedule RC-E, part I).....	\$ 2200b
1. Noninterest-bearing.....	\$ 6631b
2. Interest-bearing.....	\$ 6636b
B. In foreign offices, Edge and Agreement subsidiaries, and IBFs (from FFIEC Form 031's Schedule RC-E, part II).....	\$ 2200b
1. Noninterest-bearing.....	\$ 6631b
2. Interest-bearing.....	\$ 6636b
14. Federal funds purchased and securities sold under agreements to repurchase	
A. Federal funds purchased in domestic offices.....	\$ 8993b
B. Securities sold under agreements to repurchase.....	\$ 8995b
15. Trading liabilities.....	\$ 3548b
16. Other borrowed money (includes mortgage indebtedness and obligations under capitalized leases) (from FFIEC Form 031's Schedule RC-M).....	\$ 3190b
17. Not applicable.	
18. Not applicable.	
19. Subordinated notes and debentures.....	\$ 3200b
20. Other liabilities (from FFIEC Form 031's Schedule RC-G).....	\$ 2930b
21. Total liabilities (sum of Lines 13 through 20).....	\$ 2948b
22. Not applicable.	
Equity Capital	
23. Perpetual preferred stock and related surplus.....	\$ 3828b
24. Common stock.....	\$ 3230b
25. Surplus (exclude all surplus related to preferred stock).....	\$ 3839b
26A. Retained earnings.....	\$ 3632b
B. Accumulated other comprehensive income.....	\$ 8530b
C. Other equity capital components.....	\$ A130b
27A. Total bank equity capital (sum of Lines 23 through 26.C).....	\$ 3210b
B. Non-controlling (minority) interests in consolidated subsidiaries.....	\$ 3000b
28. Total equity capital (sum of Lines 27A and 27B).....	\$ 6105b
29. Total liabilities and equity capital (sum of Lines 21 and 28).....	\$ 3300b

Name of Firm: _____
As of: _____

FOCUS
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REGULATORY CAPITAL (INFORMATION AS REPORTED ON FFIEC FORM 031 - SCHEDULE RC-R)

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

<u>Capital</u>	<u>Totals</u>
1. Total bank equity capital (from FFIEC Form 031's Schedule RC, Line 27A).....	\$ <u>3210b</u>
2. Tier 1 capital.....	\$ <u>8274b</u>
3. Tier 2 capital.....	\$ <u>5311b</u>
4. Tier 3 capital allocated for market risk.....	\$ <u>1395b</u>
5. Total risk-based capital.....	\$ <u>3792b</u>
6. Total risk-weighted assets.....	\$ <u>A223b</u>
7. Total assets for leverage capital purposes.....	\$ <u>L138b</u>

Capital Ratios (Column B is to be completed by all banks. Column A is to be completed by banks with financial subsidiaries.)

	<u>Column A</u>	<u>Column B</u>
8. Tier 1 Leverage ratio.....	\$ <u>7273b</u>	\$ <u>7204b</u>
9. Tier 1 risk-based capital ratio.....	<u>7274b</u>	\$ <u>7206b</u>
10. Total risk-based capital ratio.....	<u>7275b</u>	\$ <u>7205b</u>

Name of Firm: _____

As of: _____

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

	<u>Totals</u>
1. Total interest income	\$ 4107b
2. Total interest expense	\$ 4073b
3. Total noninterest income	\$ 4079b
4. Total noninterest expense	\$ 4093b
5. Realized gains (losses) on held-to-maturity securities	\$ 3521b
6. Realized gains (losses) on available-for-sale securities	\$ 3196b
7. Income (loss) before income taxes and extraordinary items and other adjustments	\$ 4301b
8. Net income (loss) attributable to bank	\$ 4340b
9. Trading revenue (from cash instruments and derivative instruments) (sum of Memoranda Lines 8a through 8e on FFIEC Form 031's Schedule RI)	
A. Interest rate exposures	\$ 8757b
B. Foreign exchange exposures	\$ 8758b
C. Equity security and index exposures	\$ 8759b
D. Commodity and other exposures	\$ 8760b
E. Credit exposures	\$ F186b
Lines 9F and 9G are to be completed by banks with \$100 billion or more in total assets that are required to complete lines 9A through 9E above.	
F. Impact on trading revenue of changes in the creditworthiness of the bank's derivative counterparties on the bank's derivative assets) (included on Lines 8a through 8e on FFIEC Form 031's Schedule RI)	\$ K090b
G. Impact on trading revenue of changes in the creditworthiness of the bank on the bank's derivative liabilities (included in Lines 8a through 8e on FFIEC Form 031's Schedule RI)	\$ K091b
10. Net gains (losses) recognized in earnings on credit derivatives that economically hedge credit exposures held outside the trading account	
A. Net gains (losses) on credit derivatives held for trading	\$ C889b
B. Net gains (losses) on credit derivatives held for purposes other than trading	\$ C890b
11. Credit losses on derivatives	\$ A251b

Name of Firm: _____
As of: _____

**FOCUS
Report
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Part 2**

**COMPUTATION FOR DETERMINATION OF THE AMOUNT TO BE MAINTAINED IN THE SPECIAL ACCOUNT
FOR THE EXCLUSIVE BENEFIT OF SECURITY-BASED SWAP CUSTOMERS – RULE 18a-4, APPENDIX A**

Items on this page to be reported by a: **Bank SBSD**

CREDIT BALANCES

1. Free credit balances and other credit balances in the accounts carried for security-based swap customers.....	\$	9999
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (see Note B).....	\$	9999
3. Monies payable against security-based swap customers' securities loaned (see Note C).....	\$	9999
4. Security-based swap customers' securities failed to receive (see Note D).....	\$	9999
5. Credit balances in firm accounts attributable to principal sales to security-based swap customers.....	\$	9999
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days.....	\$	9999
7. Market value of short security count differences over 30 calendar days old.....	\$	9999
8. Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days.....	\$	9999
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days.....	\$	9999
10. Other (List: _____).....	\$	9999
11. TOTAL CREDITS.....	\$	9999

DEBIT BALANCES

12. Debit balances in accounts carried for security-based swap customers, excluding unsecured accounts and accounts doubtful of collection (see Note E).....	\$	9999
13. Securities borrowed to effectuate short sales by security-based swap customers and securities borrowed to make delivery on security-based swap customers' securities failed to deliver.....	\$	9999
14. Failed to deliver of security-based swap customers' securities not older than 30 calendar days.....	\$	9999
15. Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in accounts carried for security-based swap customers (see Note F).....	\$	9999
Margin related to security future products written, purchased or sold in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivative clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) (see Note G).....	\$	9999
17. Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q-1).....	\$	9999
18. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer.....	\$	9999
19. Other (List: _____).....	\$	9999
20. TOTAL 18a-4a DEBITS.....	\$	9999

RESERVE COMPUTATION

21. Excess of total debits over total credits (Line 21 less Line 11).....	\$	9999
22. Excess of total credits over total debits (Line 11 less Line 21).....	\$	9999
23. Amount held on deposit in "Reserve Bank Account(s)," including value of qualified securities, at end of reporting period.....	\$	9999
24. Amount of deposit (or withdrawal) including \$ 9999 value of qualified securities.....	\$	9999
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including \$ 9999 value of qualified securities.....	\$	9999
27. Date of deposit (MM/DD/YY).....	\$	9999

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 2**

INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 18a-4

Items on this page to be reported by a: Bank SBSD

State the market valuation and number of items of:

1. Security-based swap customers' excess securities collateral not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frame specified under Rule 18a-4. Notes A and B \$ 9999
 A. Number of items 9999
2. Security-based swap customers' excess securities collateral for which instructions to reduce possession or control had not been issued as of the report date under Rule 18a-4 \$ 9999
 A. Number of items 9999
3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of security-based swap customers' excess securities collateral have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 18a-4 Yes 9999 No 9999

Notes:

- A – Do not include in Line 1 security-based swap customers' excess securities collateral required by Rule 18a-4, to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 18a-4.
- B – State separately in response to Line 1 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

Name of Firm: _____

As of: _____

Items on this page to be reported by: A Futures Commission Merchant

NET CAPITAL REQUIRED

A. Risk-based requirement

i. Amount of customer risk

Maintenance margin..... \$ 7415

ii. Enter 8% of Line A.i..... \$ 7425

iii. Amount of non-customer risk

Maintenance margin..... \$ 7435

iv. Enter 8% of Line A.iii..... \$ 7445

v. Enter the sum of Lines A.ii and A.iv..... \$ 7455

B. Minimum dollar amount requirement..... \$ 7465

C. Other NFA requirement..... \$ 7475

D. Minimum CFTC net capital requirement

Enter the greatest of Lines A.v, B, or C..... \$ 7490

Note: If amount on Line D is greater than the minimum net capital requirement computed on Item 3760, then enter this greater amount on Item 3760. The greater of the amount required by the SEC or CFTC is the minimum net capital requirement.

CFTC early warning level – enter the greatest of 110% of Line A.v. or 150% of Line B or 150% of Line C or \$375,000..... \$ 7495

Name of Firm: _____

As of: _____

STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION
FOR CUSTOMERS TRADING ON U.S. COMMODITY EXCHANGES

Items on this page to be reported by a: A Futures Commission Merchant

SEGREGATION REQUIREMENTS

1. Net ledger balance

A. Cash \$ 7010

B. Securities (at market) \$ 7020

2. Net unrealized profit (loss) in open futures contracts traded on a contract market \$ 7030

3. Exchange traded options

A. Add: Market value of open option contracts purchased on a contract market \$ 7032

B. Deduct: Market value of open option contracts granted (sold) on a contract market \$ () 7033

4. Net equity (deficit) (total of Lines 1, 2 and 3) \$ 7040

5. Accounts liquidating to a deficit and accounts with debit balances – gross amount \$ 7045

Less: amount offset by customer owned securities \$ () 7047 \$ 7050

6. Amount required to be segregated (add Lines 4 and 5) \$ 7060

FUNDS IN SEGREGATED ACCOUNTS

7. Deposited in segregated funds bank accounts

A. Cash \$ 7070

B. Securities representing investments of customers' funds (at market) \$ 7080

C. Securities held for particular customers or option customers in lieu of cash (at market) \$ 7090

8. Margin on deposit with derivative clearing organizations of contract markets

A. Cash \$ 7100

B. Securities representing investments of customers' funds (at market) \$ 7110

C. Securities held for particular customers or option customers in lieu of cash (at market) \$ 7120

9. Net settlement from (to) derivative clearing organizations of contract markets \$ 7130

10. Exchange traded options

A. Value of open long option contracts \$ 7132

B. Value of open short option contracts \$ () 7133

11. Net equities with other FCMs

A. Net liquidating equity \$ 7140

B. Securities representing investments of customers' funds (at market) \$ 7160

C. Securities held for particular customers or option customers in lieu of cash (at market) \$ 7170

12. Segregated funds on hand (describe: _____) \$ 7150

13. Total amount in segregation (add Lines 7 through 12) \$ 7180

14. Excess (deficiency) funds in segregation (subtract Line 6 from Line 13) \$ 7190

15. Management target amount for excess funds in segregation \$ 9999

16. Excess (deficiency) funds in segregation over management target amount excess \$ 9999

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 3**

**STATEMENT OF CLEARED SWAPS CUSTOMER SEGREGATION REQUIREMENTS AND FUNDS IN CLEARED SWAPS CUSTOMER
ACCOUNTS UNDER SECTION 4D(F) OF THE COMMODITY EXCHANGE ACT**

Items on this page to be Reported by: A Futures Commission Merchant

CLEARED SWAPS CUSTOMER REQUIREMENTS

1. Net ledger balance		
A. Cash.....	\$	8500
B. Securities (at market).....	\$	8510
2. Net unrealized profit (loss) in open cleared swaps	\$	8520
3. Cleared swaps options		
A. Market value of open cleared swaps option contracts purchased	\$	8530
B. Market value of open cleared swaps option contracts granted (sold).....	\$ (	8540
4. Net equity (deficit) (add Lines 1, 2, and 3)	\$	8550
5. Accounts liquidating to a deficit and accounts with debit balances – gross amount	\$	8560
Less: amount offset by customer owned securities	\$ (	8570
6. Amount required to be segregated for cleared swaps customers (add Lines 4 and 5).....	\$	8590

FUNDS IN CLEARED SWAPS CUSTOMER SEGREGATED ACCOUNTS

7. Deposited in cleared swaps customer segregated accounts at banks		
A. Cash.....	\$	8600
B. Securities representing investments of cleared swaps customers' funds (at market)	\$	8610
C. Securities held for particular cleared swaps customers in lieu of cash (at market).....	\$	8620
8. Margins on deposit with derivatives clearing organizations in cleared swaps customer segregated accounts		
A. Cash.....	\$	8630
B. Securities representing investments of cleared swaps customers' funds (at market)	\$	8640
C. Securities held for particular cleared swaps customers in lieu of cash (at market).....	\$	8650
9. Net settlement from (to) derivatives clearing organizations	\$	8660
10. Cleared swaps options		
A. Value of open cleared swaps long option contracts.....	\$	8670
B. Value of open cleared swaps short option contracts.....	\$ (	8680
11. Net equities with other FCMs		
A. Net liquidating equity	\$	8690
B. Securities representing investments of cleared swaps customers' funds (at market)	\$	8700
C. Securities held for particular cleared swaps customers in lieu of cash (at market)	\$	8710
12. Cleared swaps customer funds on hand (describe:) .	\$	8715
13. Total amount in cleared swaps customer segregation (add Lines 7 through 12)	\$	8720
14. Excess (deficiency) funds in cleared swaps customer segregation (subtract Line 6 from Line 13).....	\$	8730
15. Management target amount for excess funds in cleared swaps segregated accounts	\$	9999
16. Excess (deficiency) funds in cleared swaps customer segregated accounts over (under) management target excess	\$	9999

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 3

STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION
FOR CUSTOMERS' DEALER OPTIONS ACCOUNTS

Items on this page to be reported by a: A Futures Commission Merchant

1. Amount required to be segregated in accordance with 17 C.F.R. § 32.6 \$ 7200
2. Funds/property in segregated accounts
- A. Cash..... \$ 7210
- B. Securities (at market value)..... \$ 7220
- C. Total funds/property in segregated accounts..... \$ 7230
3. Excess (deficiency) funds in segregation (subtract Line 2C from Line 1) \$ 7240

Name of Firm: _____

As of: _____

STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS
FOR FOREIGN FUTURES AND FOREIGN OPTIONS CUSTOMERS PURSUANT TO CFTC REGULATION 30.7

Items on this page to be reported by a: A Futures Commission Merchant

FOREIGN FUTURES AND FOREIGN OPTIONS SECURED AMOUNTS

_____ 9999 Amount required to be set aside pursuant to law, rule, or regulation of a foreign government or a rule of a self-regulatory organization authorized thereunder

1. Net ledger balance – Foreign futures and foreign options trading – All customers

A. Cash..... \$ _____ 9999

B. Securities (at market)..... \$ _____ 9999

2. Net unrealized profit (loss) in open futures contracts traded on a foreign board of trade..... \$ _____ 9999

3. Exchange traded options..... \$ _____ 9999

A. Market value of open option contracts purchased on a foreign board of trade..... \$ _____ 9999

B. Market value of open option contracts granted (sold) on a foreign board of trade..... \$ _____ 9999

4. Net equity (deficit) (add Lines 1, 2, and 3)..... \$ _____ 9999

5. Accounts liquidating to a deficit and accounts with debit balances – gross amount..... \$ _____ 9999

Less: Amount offset by customer owned securities..... \$ _____ 9999 \$ _____ 9999

6. Amount required to be set aside as the secured amount – Net liquidating equity method (add Lines 4 and 5)..... \$ _____ 9999

7. Greater of amount required to be set aside pursuant to foreign jurisdiction (above) or Line 6..... \$ _____ 9999

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 3

STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS
FOR FOREIGN FUTURES AND FOREIGN OPTIONS CUSTOMERS PURSUANT TO CFTC REGULATION 30.7

Items on this page to be reported by: A Futures Commission Merchant

FUNDS DEPOSITED IN SEPARATE 17 C.F.R. § 30.7 ACCOUNTS

1. Cash in banks

A. Banks located in the United States \$ 7500

B. Other banks qualified under 17 C.F.R. § 30.7

Name(s): 7510 \$ 7520 \$ 7530

2. Securities

A. In safekeeping with banks located in the United States \$ 7540

B. In safekeeping with other banks designated by 17 C.F.R. § 30.7

Name(s): 7550 \$ 7560 \$ 7570

3. Equities with registered futures commission merchants

A. Cash \$ 7580

B. Securities \$ 7590

C. Unrealized gain (loss) on open futures contracts \$ 7600

D. Value of long option contracts \$ 7610

E. Value of short option contracts \$ (7615) \$ 7620

4. Amounts held by clearing organizations of foreign boards of trade

Name(s): 7630

A. Cash \$ 7640

B. Securities \$ 7650

C. Amount due to (from) clearing organizations - daily variation \$ 7660

D. Value of long option contracts \$ 7670

E. Value of short option contracts \$ (7675) \$ 7680

5. Amounts held by members of foreign boards of trade

Name(s): 7690

A. Cash \$ 7700

B. Securities \$ 7710

C. Unrealized gain (loss) on open futures contracts \$ 7720

D. Value of long option contracts \$ 7730

E. Value of short option contracts \$ (7735) \$ 7740

6. Amounts with other depositories designated by a foreign board of trade

Name(s): 7750 \$ 7760

7. Segregated funds on hand (describe: 7765) .. \$ 7765

8. Total funds in separate 17 C.F.R. § 30.7 accounts (Item 7370) \$ 7770

9. Excess (deficiency) set aside funds for secured amount
(Line Item 7770 minus Line 7 of immediately preceding page) \$ 9999

10. Management target amount for excess funds in separate
17 C.F.R. § 30.7 accounts \$ 9999

11. Excess (deficiency) funds in separate 17 C.F.R. § 30.7 accounts
over (under) management target excess \$ 9999

Name of Firm: _____

As of: _____

**FOCUS
Report
FORM SBS
Part 4**

SCHEDULE 1 – AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

<u>Aggregate Securities, Commodities, Swaps Positions</u>	<u>LONG</u>	<u>SHORT</u>
1. U.S. treasury securities	\$ _____ 8200	\$ _____ 8201
2. U.S. government agency and U.S. government-sponsored enterprises	\$ _____ 8210	\$ _____ 8211
A. Mortgage-backed securities issued by U.S. government agency and U.S. government-sponsored enterprises	\$ _____ 9999	\$ _____ 9999
B. Debt securities issued by U.S. government agency and U.S. government-sponsored enterprises	\$ _____ 9999	\$ _____ 9999
3. Securities issued by states and political subdivisions in the U.S.	\$ _____ 8220	\$ _____ 8221
4. Foreign securities		
A. Debt securities	\$ _____ 8230	\$ _____ 8231
B. Equity securities	\$ _____ 8235	\$ _____ 8236
5. Money market instruments	\$ _____ 8240	\$ _____ 8241
6. Private label mortgage backed securities	\$ _____ 8250	\$ _____ 8251
7. Other asset-backed securities	\$ _____ 8260	\$ _____ 8261
8. Corporate obligations	\$ _____ 8270	\$ _____ 8271
9. Stocks and warrants (other than arbitrage positions)	\$ _____ 8280	\$ _____ 8281
10. Arbitrage	\$ _____ 8290	\$ _____ 8291
Spot commodities	\$ _____ 8330	\$ _____ 8331
12. Security-based swaps		
A. Debt security-based swaps (other than credit default swaps)		
1. Cleared	\$ _____ 9999	\$ _____ 9999
2. Non-cleared	\$ _____ 9999	\$ _____ 9999
B. Equity security-based swaps		
1. Cleared	\$ _____ 9999	\$ _____ 9999
2. Non-cleared	\$ _____ 9999	\$ _____ 9999
C. Credit default security-based swaps		
1. Cleared	\$ _____ 9999	\$ _____ 9999
2. Non-cleared	\$ _____ 9999	\$ _____ 9999
D. Other security-based swaps		
1. Cleared	\$ _____ 9999	\$ _____ 9999
2. Non-cleared	\$ _____ 9999	\$ _____ 9999
13. Mixed swaps		
A. Cleared	\$ _____ 9999	\$ _____ 9999
B. Non-cleared	\$ _____ 9999	\$ _____ 9999

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 4

SCHEDULE 1 - AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

	LONG	SHORT
14. Swaps		
A. Interest rate swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
B. Foreign exchange swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
C. Commodity swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
D. Debt index swaps (other than credit default swaps)		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
E. Equity index swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
F. Credit default swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
G. Other swaps		
1. Cleared	\$ 9999	\$ 9999
2. Non-cleared	\$ 9999	\$ 9999
15. Other derivatives and options	\$ 8295	\$ 8296
16. Securities with no ready market		
A. Equity	\$ 8340	\$ 8341
B. Debt	\$ 8345	\$ 8346
C. Other (include limited partnership interests)	\$ 8350	\$ 8351
17. Other securities and commodities	\$ 8360	\$ 8361
18. Total (sum of Lines 1-17)	\$ 8370	\$ 8371

Name of Firm: _____
As of: _____

**FOCUS
Report
FORM SBS
Part 4**

SCHEDULE 2 – CREDIT CONCENTRATION REPORT FOR FIFTEEN LARGEST EXPOSURES IN DERIVATIVES

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

I. By Current Net Exposure

Counterparty Identifier	Internal Credit Rating	Gross Replacement Value		Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
		Receivable (Gross Gain)	Payable (Gross Loss)				
1.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
2.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
3.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
4.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
5.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
6.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
7.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
8.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
9.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
10.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
11.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
12.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
13.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
14.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
15.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
All other counterparties	N/A	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
Totals:		\$ 7810	\$ 7811	\$ 7812	\$ 7813	\$ 7814	\$ 9999

II. By Total Exposure

Counterparty Identifier	Internal Credit Rating	Gross Replacement Value		Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
		Receivable (Gross Gain)	Payable (Gross Loss)				
1.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
2.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
3.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
4.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
5.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
6.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
7.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
8.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
9.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
10.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
11.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
12.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
13.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
14.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
15.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
All other counterparties	N/A	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
Totals:		\$ 7810	\$ 7811	\$ 7812	\$ 7813	\$ 7814	\$ 9999

Name of Firm: _____

As of: _____

FOCUS
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Part 4

SCHEDULE 3 - PORTFOLIO SUMMARY OF DERIVATIVES EXPOSURES BY INTERNAL CREDIT RATING

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

Internal Credit Rating	Gross Replacement Value		Net Replacement Value	Current Net Exposure		Total Exposure	Margin Collected	
	Receivable	Payable						
1.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
2.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
3.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
4.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
5.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
6.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
7.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
8.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
9.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
10.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
11.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
12.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
13.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
14.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
15.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
16.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
17.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
18.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
19.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
20.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
21.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
22.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
23.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
24.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
25.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
26.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
27.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
28.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
29.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
30.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
31.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
32.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
33.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
34.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
35.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
36.	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
Unrated	9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999	\$ 9999
Totals:		\$ 7822	\$ 7823	\$ 7821	\$ 7820	\$ 9999	\$ 9999	\$ 9999

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 4

SCHEDULE 4 – GEOGRAPHIC DISTRIBUTION OF DERIVATIVES EXPOSURES FOR TEN LARGEST COUNTRIES

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

I. By Current Net Exposure

Country	Gross Replacement Value		Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
	Receivable	Payable				
1.	9999	9999	9999	9999	9999	9999
2.	9999	9999	9999	9999	9999	9999
3.	9999	9999	9999	9999	9999	9999
4.	9999	9999	9999	9999	9999	9999
5.	9999	9999	9999	9999	9999	9999
6.	9999	9999	9999	9999	9999	9999
7.	9999	9999	9999	9999	9999	9999
8.	9999	9999	9999	9999	9999	9999
9.	9999	9999	9999	9999	9999	9999
10.	9999	9999	9999	9999	9999	9999
Totals:	\$	7803	\$	7802	\$	7801

II. By Total Exposure

Country	Gross Replacement Value		Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
	Receivable	Payable				
1.	9999	9999	9999	9999	9999	9999
2.	9999	9999	9999	9999	9999	9999
3.	9999	9999	9999	9999	9999	9999
4.	9999	9999	9999	9999	9999	9999
5.	9999	9999	9999	9999	9999	9999
6.	9999	9999	9999	9999	9999	9999
7.	9999	9999	9999	9999	9999	9999
8.	9999	9999	9999	9999	9999	9999
9.	9999	9999	9999	9999	9999	9999
10.	9999	9999	9999	9999	9999	9999
Totals:	\$	7803	\$	7802	\$	7801

Name of Firm: _____
As of: _____

FOCUS
Report
FORM SBS
Part 5

SCHEDULE 1 – AGGREGATE SECURITY-BASED SWAP AND SWAP POSITIONS

Items to be Reported by: Bank SBSDs
Bank MSBSPs

Aggregate Positions

LONG

SHORT

1. Security-based swaps

A. Debt security-based swaps (other than credit default swaps)

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

B. Equity security-based swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

C. Credit default security-based swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

D. Other security-based swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

2. Mixed swaps

A. Cleared	\$ _____	9999	\$ _____	9999
B. Non-cleared	\$ _____	9999	\$ _____	9999

3. Swaps

A. Interest rate swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

B. Foreign exchange swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

C. Commodity swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

D. Debt index swaps (other than credit default swaps)

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

E. Equity index swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

F. Credit default swaps

1. Cleared	\$ _____	9999	\$ _____	9999
2. Non-cleared	\$ _____	9999	\$ _____	9999

Name of Firm: _____

As of: _____

FOCUS
Report
FORM SBS
Part 5

SCHEDULE 1 - AGGREGATE SECURITY-BASED SWAP AND SWAP POSITIONS

Items to be Reported by: Bank SBSDs
Bank MSBSPs

G. Other swaps

1. Cleared	\$	_____	9999	\$	_____	9999
2. Non-cleared	\$	_____	9999	\$	_____	9999
4. Other derivatives.....	\$	_____	9999	\$	_____	9999
5. Total (sum of Lines 1-4).....	\$	_____	9999	\$	_____	9999

Name of Firm: _____
As of: _____

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FOCUS REPORT FORM SBS INSTRUCTIONS

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Computation of Net Capital (Filer Not Authorized to Use Models)

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Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer)

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Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes

Information for Possession or Control Requirements under Rule 15c3-3

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Information for Possession or Control Requirements under Rule 18a-4

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Schedule 1 – Aggregate Security-Based Swap and Swap Positions

GENERAL INSTRUCTIONS

FOCUS Report Form SBS ("Form SBS") constitutes the basic report required of those firms registered with the Securities and Exchange Commission ("Commission") as security-based swap dealers ("SBSDs") or major security-based swap participants ("MSBSPs"). The instructions issued from time-to-time must be used in preparing Form SBS and are considered an integral part of this report.

Who Must File

An SBSD or MSBSP must file Form SBS. The Form consists of five Parts, which apply to an SBSD or MSBSP based on the firm's registration status: (1) an SBSD or MSBSP that is not also registered as a broker-dealer or bank (respectively, a "stand-alone SBSD" or "stand-alone MSBSP"); (2) an SBSD or MSBSP that also is registered as a broker-dealer (respectively, a "broker-dealer SBSD" or "broker-dealer MSBSP"); (3) an SBSD or MSBSP supervised by a prudential regulator (respectively, a "bank SBSD" or "bank MSBSP"); or (4) any of the above if the SBSD or MSBSP also is registered as a futures commission merchant ("FCM"). An SBSD or MSBSP must complete: (1) Parts 1 and 4 of Form SBS if it is a stand-alone SBSD, broker-dealer SBSD, stand-alone MSBSP, or broker-dealer MSBSP; or (2) Parts 2 and 5 of Form SBS if it is a bank SBSD or bank MSBSP. In addition to completing those parts, the SBSD or MSBSP also must complete Part 3 if it is also registered as an FCM.

Filing Requirements

Form SBS must be filed by nonbank SBSDs and nonbank MSBSPs within 17 business days of the end of the month in accordance with 17 C.F.R. § 240.17a-5 or 17 C.F.R. § 240.18a-7, as applicable. Form SBS must be filed by bank SBSDs and bank MSBSPs within 17 business days of the end of the quarter in accordance with 17 C.F.R. § 240.18a-7.

Form SBS must be filed with the firm's designated examining authority ("DEA"), or if none, then with the Commission or its designee. The name of the SBSD or MSBSP and the report's effective date must be repeated on each sheet of the report submitted. If no response is made to a line item or subdivision thereof, it constitutes a representation that the SBSD or MSBSP has nothing to report.

Consolidated Reporting

In computing net capital, firms should consolidate their assets and liabilities in accordance with 17 C.F.R. §§ 240.15c3-1c or 18a-1c, as applicable.

Currency

Foreign currency may be expressed in terms of U.S. dollars at the rate of exchange as of the report's effective date and, where carried in conjunction with the U.S. dollar, balances for the same accountholder may be consolidated with U.S. dollar balances and the gross or net position reported in its proper classification, provided the foreign currency is not subject to any restriction as to conversion.

Rounding

As a general rule, money amounts should be expressed in whole dollars. No valuation should be used which is higher than the actual valuation, *i.e.*, for \$170,000.85, use \$170,000 but not \$170,001. However, for *any or all-short* valuations, round up the valuation to the nearest dollar, *i.e.*, for \$180,000.17, use \$180,001 but not \$180,000. Money amounts should be expressed in whole dollars.

U.S. Generally Accepted Accounting Principles

Financial statements must be prepared in conformity with U.S. generally accepted accounting principles, applied on a basis consistent with that of the preceding report and must include, in the basic statement or accompanying footnotes, all informative disclosures necessary to make the statement a clear expression of the organization's financial and operational condition. The broker or dealer must report all data after proper accruals have been made for income and expense not recorded in the books of account and adequate reserves have been provided for deficits in customer or broker accounts, unrecorded liabilities, security differences, dividends and similar items.

The amount of terms (including commitment fees and the conditions under which lines may be withdrawn) of unused lines of credit for short-term financing must be disclosed, if significant, in notes to the financial statements.

Definitions

"Alternative standard" refers to the alternative standard for computing net capital based on aggregate debit items, in accordance with 17 C.F.R. § 240.15c3-1.

"Aggregate indebtedness" is defined in 17 C.F.R. § 240.15c3-1.

"Bona fide arbitrage" is defined in 17 C.F.R. § 240.15c3-1.

"Open contractual commitment" is defined in 17 C.F.R. § 240.15c3-1.

"Current net exposure" is defined as the net replacement value minus the fair market value of collateral collected that may be applied under applicable rules (e.g., taking into account haircuts to the fair market value of the collateral required under applicable rules).

"Customer" and "non-customer" are defined in 17 C.F.R. § 240.15c3-1.

"Exempted securities" is defined in section 3 of the Securities Exchange Act of 1934.

"Gross replacement value" and "Gross replacement value – receivable" are defined as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a positive mark-to-market value to the firm (*i.e.*, are receivable positions of the firm), without applying any netting or collateral.

"Gross replacement value – payable" is defined as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a negative mark-to-market value to the firm (*i.e.*, are payable positions of the firm), without applying any netting or collateral.

"Margin collected" is defined as the amount of margin collateral collected that can be applied against the firm's total exposure under applicable rules.

"Net capital" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Net replacement value" is defined as the amount of the "gross replacement value – receivable" minus the amount of the "gross replacement value – payable" that may be netted for each counterparty in accordance with applicable rules.

"Omnibus" refers to an arrangement whereby one firm settles transactions and holds securities in an account on behalf of another firm and its customers. The clearing firm only knows the other firm and does not know the customers of the carrying firm.

"Prudential regulator" is defined in section 3 of the Securities Exchange Act of 1934.

"Ready market" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Secured demand note" ("SDN") is defined in 17 C.F.R. § 240.15c3-1d.

"Securities not readily marketable" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Security-based swap customer" is defined in 17 C.F.R. § 240.18a-4.

"Total exposure" is defined as the sum of the following:

- The current net exposure,
- The amount of initial margin for cleared security-based swaps and swaps required by a clearing agency or derivatives clearing organization (regardless of whether the margin has been collected),
- The "margin amount" for non-cleared security-based swaps calculated under 17 C.F.R. § 240.18a-3,

- The initial margin for non-cleared swaps calculated under the CFTC's rules (regardless of whether the margin has been collected), and
- The maximum potential exposure as defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable, for any over-the-counter derivatives not included above.

SPECIFIC INSTRUCTIONS

COVER PAGE

The cover page must be answered in its entirety. If a line does not apply, the firm should write "None" or "N/A" on the line, as applicable.

- 13 Name of reporting entity. Provide the name of the firm filing Form SBS, as it is registered with the Commission. Do not use DBAs or divisional names. Do not abbreviate.
- 20-23, 99 Address of principal place of business. Provide the physical address (not post office box) of the firm's principal place of business.
- 30 Name of person to contact in regard to this report. The identified person need not be an officer or partner of the firm, but should be a person who can answer any questions concerning this specific report.
- 31 (Area code) Telephone no. Provide the direct telephone number of the contact person whose name appears on Line Item 30.
- 31, 35, 37, 39 Official use. This item is for use by regulatory staff only. Leave blank.
- 32, 34, 36, 38 Name(s) of subsidiaries or affiliates consolidated in this report. Provide the name of the subsidiaries or affiliate firms whose financial and operational data are combined in Form SBS with that of the firm filing Form SBS.

PART 1

Statement of Financial Condition

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs. Firms should report their assets as allowable or non-allowable in accordance with 17 C.F.R. § 240.15c3-1, 17 C.F.R. § 240.18a-1, or 17 C.F.R. § 240.18a-2, as applicable. With respect to liabilities, the columns entitled "A.I. Liabilities" and "Non-A.I. Liabilities" should only be completed by broker-dealers electing to comply with the aggregate indebtedness standard under 17 C.F.R. § 240.15c3-1.

- 120 Total securities – includes encumbered securities. Report here the market value of total securities that are encumbered. Securities should be treated as encumbered when the firm transfers them to a creditor and that creditor has the right by contract or custom to sell or re-pledge the collateral. Encumbered inventory may be reported on a settlement date basis even if total inventory is reported on a trade date basis. Firms that introduce their proprietary accounts do not need to report the value of encumbered securities held by the carrying/clearing firm.
- 200 Allowable – cash. Report unrestricted cash balances. Do not report:
- Bank-negotiable certificates of deposits or similar bank money market instruments. Report bankers' acceptances, certificates of deposit, commercial paper, and money market instruments on Line Item 849.
 - Petty cash. Report it on Miscellaneous Non-Allowable Assets (Line Item 720).
 - Cash used to collateralize bank loans or other similar liabilities (compensating balances). Report these funds on Line Item 720.

- Overdrafts in unrelated banks. Report such overdrafts as Bank Loan (includible) (Line Item 1460) or as Drafts Payable (Line Item 1630).
- 210 Allowable – cash segregated in compliance with federal and other regulations. Report cash segregated pursuant to federal or state statutes or regulations, or the requirements of any foreign government or instrumentality thereof.
- 220 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – includible in the formula for reserve requirement under Rule 15c3-3a. Do not report continuous net settlement (“CNS”) fails to deliver here. Report them on Line Item 280.
- 999 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – includible in the formula for the deposit requirement under Rule 18a-4a. Do not report CNS fails to deliver here. Report them on Line Item 999 (Clearing organizations – Includible in the formula for the deposit requirement under Rule 18a-4a).
- 230 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – other. Do not report CNS fails to deliver here. Report them on Line Item 290.
- 260 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for reserve requirement under Rule 15c3-3a. If applicable, report here net ledger balances and losses and gains on commodities future contracts.
- 999 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for the deposit requirement under Rule 18a-4a. If applicable, report here net ledger balances and losses and gains on commodities future contracts.
- 270 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – other. If applicable, report here net ledger balances and losses and gains on commodities future contracts.
- 280 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – includible in the formula for reserve requirement under Rule 15c3-3a. Report CNS fails to deliver allocating to customers here. CNS balances may be reported on a net basis by category (i.e., customer, non-customer).
- 999 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – includible in the formula for the deposit requirement under Rule 18a-4a. Report CNS fails to deliver allocating to security-based swap customers here. CNS balances may be reported on a net basis by category (i.e., customer, non-customer).
- 290 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – other. Report CNS fails to deliver here. CNS balances may be reported on a net basis by category (i.e., customer, non-customer). Report deposits of cash with clearing organizations.
- 292 Allowable – trade date receivable. Report pending or unsettled trades that net to a receivable balance, as of trade date, across all counterparties.
- 300 Allowable – receivables from brokers/dealers and clearing organizations – other. Report other allowable receivables from brokers/dealers and clearing organizations, including floor brokerage, commissions, trade date adjustment, and all other allowable gross receivables from brokers/dealers and clearing organizations not already reported.
- 320 Allowable – receivables from customers – securities accounts – partly secured accounts. Report those portions of partly secured customer accounts that have been secured by securities deemed to have a ready market. The remaining portion of the ledger debit balance is considered nonallowable; report it as partly secured customer receivables (Line Item 560).

- 360 Allowable – securities purchased under agreements to resell. Report the gross contract value receivable (contract price) of reverse repurchase agreements that are deemed to be adequately secured. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities). Buy-sell agreements are considered financing transactions and are reported on this line item. If a firm does not take possession of the collateral securing a reverse repurchase agreement, it will be treated as a nonallowable asset and reported on Line Item 605. Reverse repurchase deficits (including buy-sell deficits) should be reported on Line Item 3610.
- 480 Allowable – investment in and receivables from affiliates, subsidiaries and associated partnerships. This amount should not be netted against a payable from different affiliates, subsidiaries, and associated partnerships.
- 500 Allowable – other assets – dividends and interest receivable. Dividends receivable and payable should not be netted; they should be recorded in separate accounts.
- 520 Allowable – other assets – loans and advances. Report amounts related to loans and advances made to employees and others that are secured by readily marketable securities, and meet the margin requirements of Regulation T (12 C.F.R. § 220), 17 C.F.R. § 240.18a-3, and/or the firm's DEA, as applicable. Do not report loans and advances to partners, directors, and officers. Report them in the appropriate category under "Receivable from non-customers", on either Line Item 340 or Line Item 350.
- 530 Allowable – other assets – miscellaneous. Report allowable assets not readily classifiable into other previously identified categories. Examples of assets reported on this line item include: future income tax benefits arising as a result of unrealized losses; good faith deposits; and deferred organization expenses, prepaid expenses, and deferred charges.
- 536 Allowable – other assets – collateral accepted under ASC 860. Report here the market value of securities received that are required to be reported under ASC 860.
- Securities held as collateral for stock loan transactions are recognized as both an asset (Securities accepted under ASC 860 (Line Item 536)) and as a liability (Obligation to return securities (Line Item 1686)).
- Example: A firm loans 100 shares of stock valued at \$1050 and receives stock collateral valued at \$1000. The market value of the collateral received should be reported on the FOCUS as follows:
- | | | | |
|--------|-----------------|------------------------------------|--------|
| Debit | FOCUS Item 536 | Securities accepted under SFAS 140 | \$1000 |
| Credit | FOCUS Item 1686 | Obligation to return securities | \$1000 |
- Reclass firm inventory at market value of \$1050 to Encumbered Inventory (Line Item 120) if loaned and applicable.
- 537 Allowable – other assets – SPE assets. Report here financial assets that were previously transferred to a special purpose entity ("SPE") that do not qualify for sale treatment under ASC 860. Financial assets that have been transferred to a qualifying SPE do not need to be reported on Form SBS. Financial assets that have been transferred to a SPE that is not a qualifying SPE fail to qualify for sale treatment generally because effective control over the assets is still maintained.
- 550 Nonallowable – receivables from brokers/dealers and clearing organizations – other. Report nonallowable or aged receivables from brokers/dealers and clearing organizations including floor brokerage, commissions, trade date adjustment, and all other nonallowable gross receivables from brokers/dealers and clearing organizations not already reported. Do not net unrelated receivables versus payables.
- 560 Nonallowable – receivables from customers – securities accounts – partly secured accounts. Report those portions of partly secured customer accounts that have not been secured by securities deemed to have a ready market. See 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Report deficits in partly secured accounts of the introducing firm. Both the carrying broker and the introducing broker must report this if their clearing agreement states that such deficits are the liability of the introducing broker.

- 605 Nonallowable – securities purchased under agreements to resell. Report the gross contract value receivable (contract price) of reverse repurchase agreements that are not deemed to be adequately secured. If collateral that secures a reverse repurchase receivable is non-marketable or illiquid, then the amount receivable is nonallowable and should be reported here. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities).
- 670 Nonallowable – investment in and receivables from affiliates, subsidiaries and associated partnerships. This amount should not be netted against payables from different affiliates or subsidiaries.
- 690 Nonallowable – other assets – dividends and interest receivable. Dividends receivable and payable are not to be netted; they should be recorded in separate accounts.
- 710 Nonallowable – other assets – loans and advances. Do not report unsecured loans and advances to partners, directors, and officers. Report them on Line Item 600.
- 750 Total – cash. This line item is equal to Line Item 200.
- 760 Total – cash segregated in compliance with federal and other regulations. This line item is equal to Line Item 210.
- 770 Total – receivables from brokers/dealers and clearing organizations – failed to deliver. This line item is the sum of Line Items 220, 999, and 230.
- 780 Total – receivables from brokers/dealers and clearing organizations – securities borrowed. This line item is the sum of Line Items 240, 999, and 250.
- 790 Total – receivables from brokers/dealers and clearing organizations – omnibus accounts. This line item is the sum of Line Items 260, 999, and 270.
- 800 Total – receivables from brokers/dealers and clearing organizations – clearing organizations. This line item is the sum of Line Items 280, 999, and 290.
- 802 Total – trade date receivable. This line item is equal to Line Item 292.
- 810 Total – receivables from brokers/dealers and clearing organizations – other. This line item is the sum of Line Items 300 and 550.
- 820 Total – receivables from customers. This line item is the sum of Line Items 310, 320, 330, 335, 560, 570, 580, and 590.
- 830 Total – receivables from non-customers. This line item is the sum of Line Items 340, 350, and 600.
- 840 Total – securities purchased under agreements to resell. This line item is the sum of Line Items 360 and 605.
- 849 Allowable – total securities, including security-based swaps, and spot commodities and swaps owned at market value. Report the long market value for securities, spot commodities, and swaps netted, including the value of derivative contracts that is allowable under 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.
- 850 Total – total securities, including security-based swaps, and spot commodities and swaps owned. This line item is equal to Line Item 849.
- 860 Total – securities owned not readily marketable. This line item is the sum of Line Items 440 and 610.
- 870 Total – other investments not readily marketable. This line item is the sum of Line Items 450 and 620.
- 880 Total – securities borrowed under subordination agreements and partners' individual and capital securities accounts. This line item is the sum of Line Items 460 and 630.
- 890 Total – secured demand notes. This line item is the sum of Line Items 470 and 640.
- 900 Total – memberships in exchanges. This line item is the sum of Line Items 650 and 660.

- 910 Total – investment in and receivables from affiliates, subsidiaries and associated partnerships. This line item is the sum of Line Items 480 and 670.
- 920 Total – property, furniture, equipment, leasehold improvements, and rights under lease agreements. This line item is the sum of Line Items 490 and 680.
- 930 Total – other assets. This line item is the sum of Line Items 500, 510, 520, 530, 536, 537, 690, 700, 710, and 720.
- 940 Total – assets. This line item is the sum of Line Items 540 and 740.
- 950 Payable to customers – securities accounts – including free credits. Do not report here funds in commodity accounts segregated in accordance with the Commodity Exchange Act. Do not report credits related to short sales of securities. Do not report here amounts reported on Line Item 999 (Security-based swap accounts payable to customers – free credits).
- 999 Payable to customers – security-based swap accounts – including free credits. Do not report credits related to short sales of securities. Do not report here amounts reported on Line Item 950.
- 960 Securities sold but not yet purchased – arbitrage. Report that part of Line Item 1620 that is deemed to be part of a bona fide arbitrage.
- 970 Liabilities subordinated to claims of creditors – cash borrowings – from outsiders. Report that portion of subordinated liabilities (cash borrowings) reported on Line Item 1710 that are owed to the firm's non-partners, non-members, or non-stockholders (outsiders).
- 980 Liabilities subordinated to claims of creditors – cash borrowings – includes equity subordination. Report that portion of subordinated liabilities (cash borrowings) reported on Line Item 1710 that are considered equity pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable, for debt to debt-equity requirements. See also 17 C.F.R. § 240.15c3-1d and 17 C.F.R. § 240.18a-1d regarding events of acceleration and default.
- 990 Liabilities subordinated to claims of creditors – securities borrowings – from outsiders. This amount represents that portion of Line Item 1720 that is securities borrowing from the firm's non-partners, non-members, or non-stockholders (outsiders).
- 1000 Liabilities subordinated to claims of creditors – pursuant to secured demand note collateral agreements – from outsiders. Report that portion of liabilities subordinated pursuant to SDN collateral agreements (Line Item 1730) that are owed to the firm's non-partners, non-members, or non-stockholders (outsiders).
- 1010 Liabilities subordinated to claims of creditors – pursuant to secured demand note collateral agreements – includes equity subordination. Report that portion of liabilities subordinated pursuant to SDN collateral agreements (Line Item 1730) that are considered equity pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable, for debt to debt-equity requirements.
See also 17 C.F.R. § 240.15c3-1d and 17 C.F.R. § 240.18a-1d regarding events of acceleration and default.
- 1020 Partnership and LLC – including limited partners. Report that portion of Line Item 1780 that represents the capital contributions of limited partners to the limited partnership. Limited liability companies ("LLCs") should leave this line item blank.
- 1480 Securities sold under repurchase agreements. Report here the gross contract value (contract price) of securities sold under repurchase agreements. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities). Buy-sell agreements resembling repurchase agreements are also reported here.
- 1490 Payable to brokers/dealers and clearing organizations – failed to receive – includible in the formula for reserve requirements under Rule 15c3-3a. Do not report here CNS failed to receive relating to customers. Report them on Line Item 1550.

- 9999 Payable to brokers/dealers and clearing organizations – failed to receive – includible in the formula for the deposit requirement under Rule 18a-4a. Do not report here CNS failed to receive relating to security-based swap customers. Report them on Line Item 9999 (Clearing organizations - includible in the formula for the deposit requirement under 17 C.F.R. § 240.18a-4a).
- 1500 Payable to brokers/dealers and clearing organizations – failed to receive – other. Do not report here CNS failed to receive relating to non-customers. Report them on Line Item 1560.
- 1530 Payable to brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for reserve requirements under Rule 15c3-3a. Report here customer-related credit balances in accounts carried by other firms pursuant to omnibus agreements.
- 9999 Payable to brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for the deposit requirement under Rule 18a-4a. Report here security-based swap customer-related credit balances in accounts carried by other firms pursuant to omnibus agreements.
- 1540 Payable to brokers/dealers and clearing organizations – omnibus accounts – other. Report here non-customer and proprietary-related credit balances in accounts carried by other firms pursuant to omnibus agreements. FCMs should also report on this line item omnibus accounts used to clear proprietary and non-customer accounts that liquidate to a deficit (payable to the other FCM). An omnibus account that the reporting FCM carries at another FCM liquidating to a deficit should not be netted against omnibus accounts that liquidate to an equity.
- 1550 Payable to brokers/dealers and clearing organizations – clearing organizations – includible in the formula for reserve requirements under Rule 15c3-3a. CNS fails to receive allocating to customers are also included on this line item. CNS balances may be reported on a net basis by category (customers or non-customers); however, they should be allocated broadly for purposes of the formulas under 17 C.F.R. § 240.15c3-3a and 17 C.F.R. § 240.18a-4a.
- 9999 Payable to brokers/dealers and clearing organizations – clearing organizations – includible in the formula for the deposit requirement under Rule 18a-4a. CNS fails to receive allocating to security-based swap customers are also included on this line item. CNS balances may be reported on a net basis by category (customers, security-based swap customers, non-customers and non-security-based swap customers); however, they should be allocated broadly for purposes of the formulas under 17 C.F.R. § 240.15c3-3a and 17 C.F.R. § 240.18a-4a.
- 1560 Payable to brokers/dealers and clearing organizations – clearing organizations – other. CNS balances may be reported on a net basis by category (customers or non-customers).
- 1562 Trade date payable. Report here pending or unsettled trades that net to a payable balance as of trade date, across all counterparties.
- 1570 Payable to brokers/dealers and clearing organizations – other. Report here all other payables to broker/dealers including commissions, floor brokerage, and trade date or settlement date adjustments. When a firm is required to prepare its net capital computation on a trade date basis, any net receivables (or payables) resulting from adjusting proprietary positions to reflect the trade date basis of accounting should be reported here. Do not net payables and receivables with unrelated entities.
- 1686 Accounts payable and accrued liabilities and expenses – obligation to return securities. Report here the market value of securities that are required to be reported pursuant to ASC 860. Report here the market value of securities received in a stock loan transaction in which the firm lent out one security and received another security in lieu of cash.
- 1687 Accounts payable and accrued liabilities and expenses – SPE liabilities. Report here liabilities of SPEs that offset financial assets previously transferred to the SPE that do not qualify for sale treatment under ASC 860. Liabilities reported here contrast with the assets reported on Line Item 537.

- 1710 Liabilities subordinated to claims of creditors – cash borrowings. SBSBs should report here cash borrowings that are subordinated to the claims of creditors, and meet the minimum requirements of 17 C.F.R. § 240.15c3-1d or 17 C.F.R. § 240.18a-1d, if applicable. These liabilities are added to net worth in the computation of net capital (see Line Item 3520).

Computation of Net Capital (Filer Authorized to Use Models)

This section must be prepared by stand-alone SBSBs, broker-dealer SBSBs, and broker-dealer MSBSPs that are authorized by the Commission to calculate net capital using internal models in accordance with 17 C.F.R. §§ 240.15c3-1e and 240.18a-1(d), as applicable.

- 3490 Deduct ownership equity not allowable for net capital. Report as a deduction any capital accounts, included as part of ownership equity on the Statement of Financial Condition, that are not allowable in the determination of net capital (*i.e.*, partners' securities contributed to the firm through their individual and capital accounts).

- 3525 Other (deductions) or allowable credits. Report deductions or addbacks that are net of any related tax benefit.

Reported amounts must also be reported on the section entitled "Capital Withdrawals."

Do not deduct from net worth or include in aggregate indebtedness any net receivables or payables resulting from the recording of proprietary positions on a trade date basis.

- 3610 Other deductions and/or charges. These charges include the following:

- Securities borrowed deficits,
- Stock loan deficits,
- Repurchase and reverse repurchase deficits,
- Aged fail-to-receive,
- The 1% deduction for fails to deliver and stock borrows allocating to fails to receive that have been excluded from the customer reserve or deposit requirement formula, as applicable,
- Other operational charges not comprehended elsewhere, and
- The 1% deduction for stock borrows collateralized by an irrevocable letter of credit.

- 3630 Other additions and/or allowable credits. Report adjustments to ownership equity related to unrealized profit or loss and to deferred tax provisions, pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Report also any flow-through capital that has been approved by the Commission pursuant to 17 C.F.R. § 240.15c3-1c, if applicable.

Unrealized losses on open contractual commitments are treated as charges when computing the net worth and the debt/equity total. See 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Unrealized profits on open contractual commitments are allowed to reduce haircuts, but not to otherwise increase net worth or net capital.

Computation of Net Capital (Filer Not Authorized to Use Models)

This section must be prepared by stand-alone SBSBs, broker-dealer SBSBs, and broker-dealer MSBSPs that are not authorized by the Commission to calculate net capital using internal models in accordance with 17 C.F.R. § 240.15c3-1e or 17 C.F.R. § 240.18a-1(d), as applicable.

Follow the instructions in the immediately preceding section entitled "Computation of Net Capital (Filer Authorized to Use Models)" to the extent it contains instructions corresponding with the applicable line item number (unless contrary instructions are provided below).

- 3732 Haircuts on securities – arbitrage. Report the deduction applied to securities considered part of a bona fide arbitrage, pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable.

3734 Haircuts on securities – other securities. This line item should include deductions applied to securities of an investment company registered under the Investment Company Act of 1940.

3736 Haircuts on securities – other. The deductions reported here should include charges related to foreign currency exposure or charges related to swaps.

Computation of Minimum Regulatory Capital Requirements (Broker-Dealer)

This section must be prepared by broker-dealer SBSBs and broker-dealer MSBs. The calculation of excess tentative net capital should only be completed by broker-dealers that are authorized to calculate net capital using internal models.

3870 Ratio requirement – 2% of aggregate debit items. FCMs must report here the greater of:

- 2% of aggregate debit items, or
- 4% of funds required to be segregated pursuant to the Commodity Exchange Act.

Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer)

This section must be prepared by stand-alone SBSBs. The calculation of excess tentative net capital should only be completed by stand-alone SBSBs that are authorized to calculate net capital using internal models.

Computation of Tangible Net Worth

This section must be prepared by stand-alone MSBs and broker-dealer MSBs.

Statement of Income (Loss)

This section must be prepared by stand-alone SBSBs, broker-dealer SBSBs, stand-alone MSBs, and broker-dealer MSBs.

The Statement of Income (Loss) is largely based on the Supplemental Statement of Income (Loss) from FINRA's Supplemental Statement of Income ("SSOI"). Follow the instructions in the section of the SSOI Instructions entitled "Specific Instructions" to the extent it contains instructions corresponding with the applicable line item number (unless contrary instructions are provided below).

For the purposes of the Statement of Income (Loss), "registered offering" means an offering registered with the SEC.

Capital Withdrawals

This section must be prepared by stand-alone SBSBs, broker-dealer SBSBs, and broker-dealer MSBs.

Name of lender or contributor. Report the name of the lender or contributor to whom the scheduled liability relates (i.e., name of partner, shareholder or subordinated lender). If an amount reported in this column relates to a discretionary liability or other addback to capital, include a description of the addback (i.e., "discretionary liability").

Amount to be withdrawn. These amounts can include:

- Equity capital that the firm expects to distribute within the next six months;
- Subordinated liabilities that are scheduled to mature within the next six months;
- Accruals and other addbacks to net capital that will not be eligible for inclusion in net capital within the next six months.

Capital Withdrawals – Recap

This section must be prepared by stand-alone SBSBs, broker-dealer SBSBs, and broker-dealer MSBs.

With respect to Lines 1 through 4, report equity and subordinated liabilities maturing or proposed to be withdrawn within the next six months and accruals which have not been deducted in the computation of net capital.

Financial and Operational Data

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs. In addition to the specific instructions below, firms should refer to the instructions accompanying Notes A and B of this section on Form SBS itself.

- 4980 Actual number of tickets executed during the reporting period. For agency transactions, count both street side and customer side as one transaction. Count as one transaction multiple executions at the same price that result in one confirmation. In the case of principal transactions, count separately dealer-to-dealer and retail transactions. Carrying and clearing firms should include in the total ticket count transactions emanating from those firms for whom they clear on a fully disclosed basis. Firms that introduce accounts on a fully disclosed basis should include transactions introduced in their ticket count.
- 4990 Number of corrected customer confirmations mailed after settlement date. Include confirmations for which the incorrect original was mailed to the customer. Consider individually multiple corrections on confirmations.
- 5374 Customers' and security-based swap customers' accounts under Rules 15c3-3 or 18a-4, as applicable. Report the aggregate market value of specific securities, other than exempted securities, which exceeds 15% of the value of all securities which collateralize all margin receivables pursuant to Note E to 17 C.F.R. § 240.15c3-3a or Note E to 17 C.F.R. § 240.18a-1a, as applicable.
- 5378 Total of personal capital borrowings due within six months. Report the total borrowed cash and/or securities that, in computing net capital, are included as proprietary capital or subordinated debt.
- 5760 Open transfers and reorganization account items over 40 days not confirmed or verified – number of items. The term "reorganization account items" includes, but is not limited to, transactions in the following: (1) "rights" subscriptions, (2) warrants exercised, (3) stock splits, (4) redemptions, (5) conversions, (6) exchangeable securities, and (7) spin-offs.
- 5820 Security suspense and differences with related money balances – long – debits. When computing net capital, regard short positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.
- 5825 Security suspense and differences with related money balances – short – debits. When computing net capital, regard long positions and related debits as proprietary commitments if they remain unresolved seven business days after discovery.
- 5830 Market value of short and long security suspense and differences without related money – debits. When computing net capital, regard the market value of short security differences as deductions if they remain unresolved seven business days after discovery. Do not net unrelated differences in the same security or in other securities.
- 5840 Market value of security record breaks – debits. Report the market values of short security record breaks that are unresolved seven business days after discovery.
- 5850 Correspondents, SBSDs, and MSBSPs – long – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are long and unresolved within seventeen business days from record date. Do not net these items.
- 5855 Correspondents, SBSDs, and MSBSPs – short – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are short and unresolved within seventeen business days from record date. Do not net these items.
- 5860 Depositories – debits. Report here the debit amount or short value applicable to all unresolved reconciling items (favorable or unfavorable) with depositories that are unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.
- 5870 Clearing organizations – long – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are long and unresolved within

seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

- 5875 Clearing organizations – short – debits. Report here the debit value applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are short and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.
- 6012 Money suspense and balancing differences – deductions. A difference, open at the report date and unresolved for seven business days after discovery, must be deducted regardless of whether the difference is resolved prior to Form SBS' filing date.
- 6020 Security suspense and differences with related money balances – long – credits. When computing net capital, regard long positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.
- 6025 Security suspense and differences with related money balances – short – credits. When computing net capital, regard long positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.
- 6040 Market value of security record breaks – credits. Report the market values of long security record breaks that are unresolved seven business days after discovery.
- 6042 Market value of security record breaks – deductions. The market values of short security record breaks are deductions to net capital only if they remain unresolved seven business days after discovery.
- 6050 Correspondents, SBSDs, and MSBSPs – long – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are long and unresolved within seventeen business days from record date.
- 6055 Correspondents, SBSDs, and MSBSPs – short – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are short and unresolved within seventeen business days from record date. Do not net these items.
- 6060 Depositories – credits. Report here the credit amount or long value applicable to all unresolved reconciling items (favorable or unfavorable) with depositories that are unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.
- 6070 Clearing organizations – long – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are long and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.
- 6075 Clearing organizations – short – credits. Report here the credit value applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are short and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.
- 6160 Open transfers and reorganization account items over 40 days not confirmed or verified – credits. Report here credits relating to open transfers and reorganization account items that have not been confirmed or verified for over forty days. See the instructions accompanying Line Item 5760 for a discussion of the term "reorganization account items."
- 6162 Open transfers and reorganization account items over 40 days not confirmed or verified – deductions. Report here the total deductions relating to open transfers and reorganization account items that have not been confirmed or verified for over forty days. See the instructions accompanying Line Item 5760 for a discussion of the term "reorganization account items."

6182 Aged fails to deliver – deductions. Report deductions for fails to deliver that are five business days or longer (or 21 business days for municipal securities).

6187 Aged fails to receive – deductions. Report deductions for fails to receive that are outstanding for more than 30 calendar days.

Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes

This section must be prepared by broker-dealer SBSBs and broker-dealer MSBSBs. See also the notes accompanying 17 C.F.R. § 240.15c3-3a.

Note that broker-dealer SBSBs must also complete the "Computation for Determination of Reserve Requirements – Rule 18a-4, Appendix A" with regard to security-based swap customers' accounts (while limiting this calculation under 17 C.F.R. § 240.15c3-3a to customers' accounts). The term "customer" is defined in 17 C.F.R. § 240.15c3-3.

Information for Possession or Control Requirements under Rule 15c3-3

This section must be prepared by broker-dealer SBSBs and broker-dealer MSBSBs.

Note that broker-dealer SBSBs must also complete the Computation for Determination of Reserve Requirements under 17 C.F.R. § 240.18a-4a with regard to security-based swap customers' security-based swap accounts (while limiting this calculation under 17 C.F.R. § 240.15c3-3a to security accounts).

Computation for Determination of PAB Requirements

This section must be prepared by broker-dealer SBSBs and broker-dealer MSBSBs.

Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A

This section must be prepared by stand-alone SBSBs and broker-dealer SBSBs. See also the notes accompanying 17 C.F.R. § 240.18a-4a.

Note that broker-dealer SBSBs must also complete the "Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes" with regard to customers' accounts (while limiting this calculation under 17 C.F.R. § 240.18a-4a to security-based swap customers' accounts). The term "security-based swap customer" is defined in 17 C.F.R. § 240.18a-4.

Information for Possession or Control Requirements under Rule 18a-4

This section must be prepared by stand-alone SBSBs and broker-dealer SBSBs.

Note that broker-dealer SBSBs must also complete the Computation for Determination of Reserve Requirements under 17 C.F.R. § 240.15c3-3a with regard to customers' security accounts (while limiting this calculation under 17 C.F.R. § 240.18a-4a to security-based swap accounts).

PART 2

Balance Sheet (Information as Reported on FFIEC Form 031 – Schedule RC)

This section must be prepared by bank SBSBs and bank MSBSBs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RC – Balance Sheet." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Regulatory Capital (Information as Reported on FFIEC Form 031 – Schedule RC-R)

This section must be prepared by bank SBSBs and bank MSBs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RC-R – Regulatory Capital." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Note that the line numbers on this section and Schedule RC-R do not match, so firms should refer to the line item numbers (appended with the letter "b" in Form SBS) when matching Schedule RC-R's instructions with this section.

Income Statement (Information as Reported on FFIEC Form 031 – Schedule RI)

This section must be prepared by bank SBSBs and bank MSBs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RI – Income Statement." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Note that the line numbers on this section and Schedule RI do not match, so firms should refer to the line item numbers (appended with the letter "b" in Form SBS) when matching Schedule RI's instructions with this section.

Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A

This section must be prepared by bank SBSBs.

This section should be prepared in accordance with the instructions accompanying the section in Part 1 of Form SBS entitled "Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A."

Information for Possession or Control Requirements under Rule 18a-4

This section must be prepared by bank SBSBs.

This section should be prepared in accordance with the instructions accompanying the section in Part 1 of Form SBS entitled "Information for Possession or Control Requirements under Rule 18a-4."

PART 3

Computation of CFTC Minimum Capital Requirements

This section must be prepared by all SBSBs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the Commodity Futures Trading Commission's Form 1-FR-FCM ("CFTC Instructions"), including the instructions accompanying the section entitled "Statement of the Computation of the Minimum Capital Requirements."

Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges

This section must be prepared by all SBSBs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges."

Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act."

Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts."

Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers."

PART 4

Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

For the applicable security-based swap, mixed swap, or swap, report the month-end gross replacement value for cleared and non-cleared receivables in the long column, and report the month-end gross replacement value for cleared and non-cleared payables in the short column. Reports totals on the "Total" row.

Terms may be defined by reference to other sections of the instructions accompanying Form SBS (e.g., Line Item 8290 (Arbitrage) may be defined by reference to Line Item 422 (Arbitrage)). Derivatives should be defined by referenced to the section of the instructions entitled "Definitions of Derivatives."

Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

On the penultimate row of each table, entitled "All other counterparties," report the requested information for all of the firm's counterparties except for the fifteen counterparties already listed on the applicable table.

Counterparty identifier. In the first table, list the fifteen counterparties to which the firm has the largest current net exposure, beginning with the counterparty to which the firm has the largest current net exposure.

In the second table, list the fifteen counterparties to which the firm has the largest total exposure, beginning with the counterparty to which the firm has the largest total exposure.

Identify each counterparty by its unique counterparty identifier.

Internal credit rating. Report the applicable counterparty's internal credit rating as assigned by the firm.

Gross replacement value – receivable. For the applicable counterparty, report here the gross replacement value of the firm's derivatives receivable positions. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable counterparty, report here the gross replacement value of the firm's derivatives payable positions. Report total on the "Totals" row.

Net replacement value. For the applicable counterparty, report here the net replacement value of the firm's derivative positions. Report total on the "Totals" row.

Current net exposure. For the applicable counterparty, report here the firm's current net exposure to derivative positions. Report total on the "Totals" row.

Total exposure. For the applicable counterparty, report here the firm's total exposure to derivative positions. Report total on the "Totals" row.

Margin collected. For the applicable counterparty, report here the margin collected to cover the firm's derivative positions. Report total on the "Totals" row.

Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

Internal credit rating. Report here the firm's internal credit rating scale. Each row should contain a separate symbol, number, or score in the firm's rating scale to denote a credit rating category and notches within a category in descending order from the highest to the lowest notch. For example, the following symbols would each represent a notch in a rating scale in descending order: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, CCC+, CCC, CCC-, CC, C and D.

Gross replacement value – receivable. For the applicable internal credit rating notch, report here the gross replacement value of the firm's derivatives receivable positions with counterparties rated at that notch. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable internal credit rating notch, report here the gross replacement value of the firm's derivatives payable positions with counterparties rated at that notch. Report total on the "Totals" row.

Net replacement value. For the applicable internal credit rating notch, report here the net replacement value of the firm's derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Current net exposure. For the applicable internal credit rating notch, report here the firm's current net exposure to derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Total exposure. For the applicable internal credit rating notch, report here the firm's total exposure to derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Margin collected. For the applicable internal credit rating notch, report here the margin collected to cover the firm's derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

Country. Identify the 10 largest countries according to the firm's current net exposure or total exposure in derivatives. In the first table, countries should be ordered according to the size of the firm's current net exposure in derivatives to them (beginning with the largest and ending with the smallest). In the first table, countries should be

ordered according to the size of the firm's total exposure in derivatives to them (beginning with the largest and ending with the smallest). A firm's counterparty is deemed to reside in the country where its main operating company is located.

Gross replacement value – receivable. For the applicable country, report here the gross replacement value of the firm's derivatives receivable positions. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable country, report here the gross replacement value of the firm's derivatives payable positions. Report total on the "Totals" row.

Net replacement value. For the applicable country, report here the net replacement value of the firm's derivative positions. Report total on the "Totals" row.

Current net exposure. For the applicable country, report here the firm's current net exposure to derivative positions. Report total on the "Totals" row.

Total exposure. For the applicable country, report here the firm's total exposure to derivative positions. Report total on the "Totals" row.

Margin collected. For the applicable country, report here the margin collected to cover the firm's derivative positions. Report total on the "Totals" row.

Part 5

Schedule 1 – Aggregate Security-Based Swap and Swap Positions

This schedule must be prepared by bank SBSDs and bank MSBSPs.

For the applicable security-based swap, mixed swap, or swap, report the quarter-end gross replacement value for cleared and non-cleared receivables in the long column, and report the quarter-end gross replacement value for cleared and non-cleared payables in the short column. Report total on the "Total" row.

Derivatives should be defined by referenced to the section of the instructions entitled "Definitions of Derivatives."

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: April 17, 2014

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

April 21, 2014

In the Matter of

Valley Forge Composite Technologies, Inc.,

File No. 500-1

ORDER OF SUSPENSION OF
TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Valley Forge Composite Technologies, Inc. because it has not filed any periodic reports since the period ended September 30, 2012.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on April 21, 2014, through 11:59 p.m. EDT on May 2, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71974 / April 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15846

In the Matter of

Valley Forge Composite Technologies, Inc.,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT¹

1. Valley Forge Composite Technologies, Inc. ("VLYFQ") (CIK No. 1332412) is a Florida corporation located in State College, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VLYFQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of \$578,982 for the prior nine months. On October 9, 2013, VLYFQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Middle District of Pennsylvania, which was still pending as of April 2, 2014. As of April 2, 2014, the common stock of VLYFQ was quoted on OTC Link, operated by OTC Markets Group, Inc. (formerly "Pink Sheets"), had thirteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹ The short form of the issuer's name is also its ticker symbol.

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of

which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Pinowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71975 / April 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15753

In the Matter of

Michael Gordon,

Respondent.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Michael Gordon ("Gordon" or "Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on February 18, 2014, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From October 2000 to February 2007, Gordon was a registered representative associated with Joseph Stevens & Co., Inc., which, at the time of his association, was a broker-dealer registered with the Commission. Joseph Stevens & Co. ceased to be registered with the Commission as of August 2008. Gordon, age 41, is a resident of New Jersey.

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2. On April 21, 2009, before the New York Supreme Court in People v. Michael Gordon, Case No. 1784-2009, Gordon pleaded guilty to one felony count of attempted enterprise corruption in violation of New York Penal Law § 110-460.20 and one count of grand larceny in the third degree in violation of New York Penal Law § 155.35. On May 4, 2012, Gordon was sentenced in that proceeding to five years of probation and ordered to pay \$46,799 in restitution.

3. The attempted enterprise corruption count to which Gordon pleaded arose out of the conduct of a broker-dealer and alleged, among other things, that between March 2001 and May 2005, Gordon participated in a scheme at Joseph Stevens & Co. to artificially raise, maintain, and manipulate the prices of certain stocks and to induce customers to buy and sell those stocks in order to receive illegally inflated profits which were shared between principals and registered representatives. The scheme involved the securities of various companies, including Cypress Bioscience, Inc. and Antigenics, Inc. The grand larceny count to which Gordon pleaded guilty alleged that between March 2001 and May 2005, Gordon stole more than three thousand dollars from an individual.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Gordon be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for the purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner P. Nowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71984 / April 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15690

In the Matter of

Kevin Patrick Brody,

Respondent.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Kevin Patrick Brody ("Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on January 27, 2014, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 as to Kevin Patrick Brody ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From November 2000 to September 2004, Brody was a registered representative associated with Joseph Stevens & Co., Inc., which at the time of his association was a broker-dealer registered with the Commission. Joseph Stevens & Co. ceased to be registered with the Commission as of August 2008. Brody, age 45, is a resident of Florida.

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2. On May 9, 2012, before the New York Supreme Court in People v. Kevin Brody, Indictment No. 3556-2006, Brody pleaded guilty to one felony count of securities fraud in violation of New York General Business Law § 352-c(5) and one felony count of grand larceny in the second degree in violation of New York Penal Law § 155.40. On June 28, 2012, Brody was sentenced in that proceeding to five years of probation and ordered to pay \$102,123 in restitution to his victims.

3. The count of securities fraud to which Brody pleaded guilty alleged, among other things, that between at least November 2000 and April 2004, Brody intentionally engaged in a scheme at Joseph Stevens & Co. with intent to defraud at least ten persons by false and fraudulent pretenses, representations, and promises and so obtained property from at least one such person while engaged in inducing and promoting the issuance, distribution, exchange, sale, negotiation, and purchase of securities. The count of grand larceny to which Brody pleaded guilty alleged, among other things, that between November 2000 and April 2004, Brody stole money in excess of \$50,000 from an individual.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Brody be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for the purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9576 / April 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15847

In the Matter of

**THE REGISTRATION
STATEMENT OF MOBILE
VAULT, INC.**

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS,
MAKING FINDINGS, AND ISSUING
STOP ORDER**

I.

A. On July 3, 2013, Mobile Vault, Inc. ("Respondent") filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a \$30,000 public offering, and amended its statement on August 26, 2013, September 18, 2013, and October 21, 2013. The registration statement has not become effective.

B. The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that administrative proceedings be, and hereby are, instituted to determine whether a stop order should issue suspending the effectiveness of Respondent's registration statement.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Making Findings, and Issuing Stop Order (the "Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent is a Florida corporation headquartered in Cameron Park, California.
2. On July 3, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a \$30,000 public offering, and amended its statement on August 26, 2013, September 18, 2013, and October 21, 2013 (together, the "Registration Statement").
3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:
 - a. The Registration Statement states that "[o]ur sole officer and director will be responsible for the business plan" to develop and sell mobile privacy and security products. The Registration Statement also states that Respondent "is entirely dependent on the efforts of its sole officer and director." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at 3384 La Canada Drive, Suite 1, Cameron Park, CA 95682." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in business activities for Respondent as represented in the Registration Statement.
 - b. The Registration Statement states that the "Board of Directors is comprised [] solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "currently devotes approximately 20-30 hours per week to our operations" and "is prepared to devote more time to our operations." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in business activities for Respondent as represented in the Registration Statement.
 - c. The Registration Statement contains a description of the background of Respondent's sole officer and director and states that her "industry and technical expertise are critical to the success of the business." In the biography section, the Registration Statement states, in part, that Respondent's sole officer and director has six years of "marketing and software design and programming experience," currently works at a software company, previously was a purchasing manager for a medical company, and earned a bachelor of

science in computer science from a South Florida university. These disclosures are untrue and misleading because Respondent's sole officer and director does not have any such expertise, experience, or education.

- d. The Registration Statement states that Respondent's sole officer and director "meets the conditions of paragraph (a)(4)(ii) of Rule 3a4-1 of the Exchange Act, in that she (A) primarily performs, or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of our company, other than in connection with transactions in securities" These disclosures are untrue and misleading because Respondent's sole officer and director has not performed and does not intend to perform the duties as represented in the Registration Statement for or on behalf of Respondent.
- e. The Registration Statement states that "[t]he shares will be sold on our behalf by our officer" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that she was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that she was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have the level of knowledge and expertise as represented in the Registration Statement, and made no such certification.
- f. The Registration Statement states that "[p]ursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by [Respondent's sole officer and director]." The Registration Statement further states that "[t]he undersigned . . . certifies that . . . the above is a true and correct copy of The Resolution that was duly adopted at a meeting of the Board of Directors, which was held on this date August 23, 2013." These disclosures are untrue and misleading because Respondent's sole officer and director did not sign the Registration Statement or Resolution on behalf of Respondent, and because Respondent's sole officer and director did not attend any meeting of the Board of Directors.
- g. The Registration Statement claims that there was a capital contribution by Respondent's sole officer and director on May 18, 2011. This disclosure is untrue and misleading because Respondent's sole officer and director made no capital contribution.
- h. The Registration Statement states that Respondent has "no plans to change our business activities or to combine with another business and are not aware of any events or circumstances that might cause us to change our plans." This disclosure is untrue and misleading because Respondent is a development

stage company with no specific business plan or purpose other than to engage in a merger or acquisition with an unidentified entity and, therefore, is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act of 1933 (the "Securities Act").

- i. The Registration Statement states that Respondent's sole officer and director "is the only 'parent' and 'promoter' of the company" and will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled and promoted by undisclosed control persons and promoters.
4. On January 14, 2014, Respondent filed a letter seeking to withdraw its Registration Statement. On January 23, 2014, the Commission denied the withdrawal of the Registration Statement. See In the Matter of Mobile Vault, Inc., Securities Act Release No. 9517 (Jan. 23, 2014).

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to issue a stop order suspending the effectiveness of the Registration Statement, as agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 8(d) of the Securities Act, that the effectiveness of the Registration Statement filed by Respondent be, and hereby is, suspended.

This Order shall be served on Respondent by certified mail forthwith.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71993 / April 22, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3820 / April 22, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15850

In the Matter of

MATTHEW D. SAMPLE,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b)(6) OF
THE SECURITIES EXCHANGE ACT OF
1934 AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Matthew D. Sample ("Respondent" or "Sample").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Matthew D. Sample, 39 years old, resides in San Diego, California. Sample was previously associated with Commission-registered investment adviser and broker-dealer firms

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and licensed as a registered representative. He is currently an employee of an investment adviser firm registered in the State of California and is an investment adviser representative of that firm. Sample has held Series 7, 63 and 65 securities licenses.

2. On April 7, 2014, a judgment was entered by consent against Sample, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5, thereunder, and Section 206(1), (2) and (4) of the Advisers Act and Rule 206(4)-8, thereunder, in the civil action entitled *Securities and Exchange Commission v. Matthew D. Sample*, Case Number 3:14-CV-01218-B, in the United States District Court for the Northern District of Texas, Dallas Division.

3. The Commission's Complaint alleged, among other things, that between October 2009 through June 2012, Sample managed an unregistered hedge fund that raised approximately \$1 million from five investors. Sample misrepresented his intended use of investor funds, misappropriated investor funds from the hedge fund for personal use and to repay prior investors, and intentionally concealed trading losses from investors. During this period, Sample was also associated with Commission-registered investment adviser and broker-dealer firms.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order;
and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct
that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71994 / April 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15851

In the Matter of Brian Williamson, Esq. Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(B) OF THE COMMISSION'S RULES OF PRACTICE
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I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(3)(i)(B)¹ of the Commission's Rules of Practice against Brian Williamson, Esq. ("Respondent" or "Williamson").

¹ Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney... who has been by name:

...

(B) ...found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

The Commission finds that:

1. Brian Williamson, age 43, is an attorney licensed to practice law in Pennsylvania and New Jersey. He is not currently eligible to practice law in either of those states because his status is "Retired."

2. Williamson was employed by Oppenheimer & Co. Inc. ("OPCO") and Oppenheimer Asset Management ("OAM"), and was a Managing Director at Oppenheimer Alternative Investment Management ("OAIM"). In those roles, he was the portfolio manager of Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"), a fund of private equity funds.

3. On August 20, 2013, the Commission instituted an administrative proceeding against Williamson, alleging that he made material false and misleading statements and omissions to investors and prospective investors concerning the valuation of OGR. In summary, the Division of Enforcement alleged that:

From September 2009 through at least mid-October 2009, Williamson sent certain prospective investors marketing materials touting an OGR internal rate of return ("IRR") that, misleadingly, did not take into account OGR fees and expenses (which would have materially lowered OGR's reported IRR); and

Beginning in late October 2009 through June 2010, Williamson amended the OGR marketing materials to take into account certain fees and expenses, but concurrently raised the reported value of OGR's largest holding, Cartesian Investors-A, LLC ("Cartesian") and, thus, materially raised OGR's total IRR. During that time period, Williamson marketed, or caused others to market, OGR to investors by, among other things, touting OGR's increased IRR.

In the Matter of Brian Williamson, Admin. Proc. File No. 3-15430, Exchange Act Release No. 34-70234.

4. On January 22, 2014, the Commission entered a consent Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(B) and 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 ("Order") against Williamson. In its Order, the Commission found that Williamson:

Made material false and misleading statements and omissions to investors and prospective investors concerning the valuation of Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR").

Sent, or directed others to send, prospective OGR investors marketing materials that reported an OGR internal rate of return ("IRR") for the quarter ended June 30, 2009 that, misleadingly, did not take into account OGR fees and expenses that would have greatly lowered OGR's reported IRR.

Misrepresented, or caused OGR to misrepresent, to OGR investors and prospective investors that the reported performance of the fund's investments was "based on the underlying managers' estimated values." In fact, during that time period, OGR's reported value of its largest single holding ("Cartesian") was based not on the value assigned by Cartesian's manager, but rather on Williamson's own materially-higher valuation, a change that materially increased OGR's reported IRR.

Made, or caused others to make, a number of additional material misrepresentations and omissions to individual OGR investors and potential investors (or their consultants) that were designed to hide his role in valuing Cartesian and to create the misleading impression that OGR's increased IRR was due to increased performance when, in fact, it was due to Williamson's revised valuation of Cartesian.

Exchange Act Release No. 34-71364.

5. The Commission also found that, through his conduct detailed in the Order and summarized above, Williamson willfully violated Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. *Id.*

III.

Based upon the foregoing, the Commission finds that Williamson has been found by the Commission in an administrative proceeding to which he was a party to have willfully violated the Federal securities laws within the meaning of Rule 102(e)(3)(i)(B) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Williamson be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Williamson be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an attorney. This Order shall be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Williamson may, within thirty days after service of this Order, file a petition with the Commission to lift the temporary suspension. If the Commission receives no petition within thirty days after service of the Order, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission shall, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Williamson personally or by certified mail at his last known address.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 71992 / April 22, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15849

In the Matter of

**Castle Arch Real Estate Investment Co.,
LLC,
Console Acquisition Corp.,
Pier Acquisition I, Inc.,
Pier Acquisition II, Inc.,
Placer Gold Corp.,
Target Acquisitions II, Inc.,
Turnstone Systems, Inc., and
Xebec International, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Castle Arch Real Estate Investment Co., LLC, Console Acquisition Corp., Pier Acquisition I, Inc., Pier Acquisition II, Inc., Placer Gold Corp., Target Acquisitions II, Inc., Turnstone Systems, Inc., and Xebec International, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Castle Arch Real Estate Investment Co., LLC (CIK No. 1321742) is a California corporation located in Kaysville, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Castle Arch is delinquent in its

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periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of over \$7.3 million for the prior nine months.

2. Console Acquisition Corp. (CIK No. 1435614) is a void Delaware corporation located in Van Nuys, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Console is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$2,650 from its September 13, 2006 inception to September 30, 2009.

3. Pier Acquisition I, Inc. (CIK No. 1453859) is a void Delaware corporation located in Westlake Village, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pier Acquisition I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended July 31, 2010, which reported a net loss of \$96,617 from its August 14, 2008 inception to July 31, 2010.

4. Pier Acquisition II, Inc. (CIK No. 1453860) is a void Delaware corporation located in Westlake Village, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pier Acquisition II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended July 31, 2009, which reported a net loss of \$58,974 from its August 14, 2008 inception to July 31, 2009.

5. Placer Gold Corp. (CIK No. 1308319) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Placer Gold is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2009, which reported a net loss of \$66,329 for the prior three months. As of April 21, 2014, the company's stock (symbol "PGCR") was traded on the over-the-counter markets.

6. Target Acquisitions II, Inc. (CIK No. 1440209) is a void Delaware corporation located in Haiku, Hawaii with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Target is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$3,987 for the prior nine months.

7. Turnstone Systems, Inc. (CIK No. 1054131) is a dissolved Delaware corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Turnstone Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009.

8. Xebec International, Inc. (CIK No. 1445742) is a Nevada corporation located in Sandy, Utah with a class of securities registered with the Commission pursuant to

Exchange Act Section 12(g). Xebec is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$13,512 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

9. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

10. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Frowner
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72010 / April 23, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3823 / April 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15852

In the Matter of

JANE E. O'BRIEN,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jane E. O'Brien ("O'Brien" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over her and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. O'Brien was employed as a registered representative at Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), which is dually-registered with the Commission as a broker-dealer and an investment adviser. O'Brien worked at a Merrill Lynch office located in Boston, Massachusetts. O'Brien was a resident of Needham, Massachusetts, and is currently incarcerated.

2. On December 21, 2012, O'Brien pled guilty to one count of securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder before the United States District Court for the District of Massachusetts, [United States v. Jane E. O'Brien, Case Number 1:12 CR 10351-1-NMG.] On June 4, 2013, a judgment of criminal conviction was entered against O'Brien. She was sentenced to a prison term of 33 months, followed by three years of supervised release and ordered to make restitution in the amount of \$240,000 and forfeiture in the amount of \$240,000.

3. The count of the criminal information to which O'Brien pled guilty alleged, inter alia, that O'Brien defrauded an investor by selling a purported private placement of shares in a privately held company and then using the investor's money for her own personal expenses.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent O'Brien's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent O'Brien be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72004 / April 23, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3821 / April 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15461

In the Matter of

TIMOTHY M. MCGINN and,
DAVID L. SMITH,

Respondents.

**ORDER MAKING FINDINGS
AND IMPOSING REMEDIAL
SANCTIONS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934 AND SECTION 203(f) OF
THE INVESTMENT ADVISERS ACT OF
1940 AS TO DAVID L. SMITH**

I.

On September 6, 2013, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against David L. Smith ("Smith" or "Respondent").

II.

In connection with these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over them and the subject matter of these proceedings and to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, ("Order"), as set forth below.

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as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Smith and Timothy M. McGinn ("McGinn") were the founders and primary owners of McGinn, Smith & Co., Inc. (MS & Co.), a broker-dealer based in Albany, NY. Smith was registered from 1981 through August 2012, and was associated with MS & Co. during that time. McGinn and Smith were also indirect owners of McGinn Smith Advisors, LLC, which was registered with the Commission as an investment adviser from January 2006 to April 2009.

2. On February 6, 2013, following a four-week trial in *United States v. David L. Smith and Timothy M. McGinn*, 12-cr-0028 (N.D.N.Y.) (DNH), a jury in the United States District Court for the Northern District of New York found McGinn and Smith guilty on multiple counts charged in the Superseding Indictment, including conspiracy to commit mail and wire fraud, mail fraud, wire fraud, securities fraud and filing a false tax return. On August 13, 2013, the Court entered judgments against McGinn and Smith. Smith was sentenced to a prison term of 120 months, and ordered to pay a fine of \$50,000 and restitution of \$5,989,726.

3. The counts of the Superseding Indictment to which Smith was found guilty alleged, among other things, that through various securities offerings from 2006 through 2009 he devised schemes to defraud investors, made misrepresentations and omissions in private placement memoranda, and misused investor funds.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Smith's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Smith be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served

as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72005 / April 23, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3551 / April 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-14044

In the Matter of	:	ORDER GRANTING APPLICATION FOR
Anthony J. Price, CPA	:	REINSTATEMENT TO APPEAR AND PRACTICE
	:	BEFORE THE COMMISSION AS AN ACCOUNTANT
	:	

On September 13, 2010, Anthony J. Price, CPA ("Price") was denied the privilege of appearing or practicing as an accountant before the Commission as a result of settled public administrative proceedings instituted by the Commission against Price pursuant to Section 4C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.¹ This order is issued in response to Price's application for reinstatement to appear and practice before the Commission as an accountant.

Price was found to have engaged in improper professional conduct with respect to his role on KMJ Corbin & Company LLP's ("KMJ") audits and reviews of Home Solutions of America, Inc.'s financial statements for the year ended December 31, 2004 through the quarter ended June 30, 2007. The Commission found that, during the relevant period, Price's actions during the engagements were unreasonable and failed to conform to applicable professional standards. Price failed to (i) obtain sufficient competent evidential matter regarding bonuses, revenues, and cost of revenues with respect to KMJ's 2004, 2005, and 2006 audit engagements; (ii) comply with PCAOB Auditing Standard No. 3, *Audit Documentation*; (iii) adequately plan the audit and properly supervise assistants in connection with the 2006 engagement; and (iv) conduct reviews of interim financial information in accordance with PCAOB standards and rules.

¹ See Accounting and Auditing Enforcement Release No. 3185 dated September 13, 2010. Price was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

Price has met all of the conditions set forth in the original order and, in his capacity as an independent accountant, has stated that he will comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including, but not limited to all requirements relating to registration, inspections, concurring partner reviews and quality control standards. In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Price attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity.

Price is currently subject to probation under the California Board of Accountancy that is scheduled to end in March 2016. Failure to abide by the terms of his probation could result in the revocation of Price's CPA license pending notice and an opportunity to be heard by the California Board of Accountancy. Price has attested that he will notify the Commission if he is found to have violated the terms of the probation. He also has attested that he understands that the revocation of his CPA license could result in the revocation of his reinstatement to appear and practice before the Commission as an accountant.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."² This "good cause" determination is necessarily highly fact specific.

On the basis of the information supplied, representations made, and undertakings agreed to by Price, it appears that he has complied with the terms of the September 13, 2010 order denying him the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Price, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, and that Price, by undertaking to comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards, in his practice before the Commission as an independent accountant has shown good cause for reinstatement. Therefore, it is accordingly,

² Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Anthony J. Price, CPA is hereby reinstated to appear and practice before the Commission as an accountant.

By the Commission.


Jill M. Peterson
Assistant Secretary

purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Section 8(d) of the Securities Act of 1933, Making Findings, and Issuing Stop Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. On December 20, 2011, Comp Services filed a Form S-1 registration statement in connection with an initial public offering of 739,000 shares of common stock (the "Registration Statement"). The Registration Statement was amended on January 27, 2012, February 22, 2012, March 14, 2012, April 9, 2012, April 23, 2012, April 26, 2012, and April 30, 2012. The registration statement as amended was declared effective on May 4, 2012. On October 17, 2013, November 27, 2013, and December 18, 2013, Comp Services filed a post-effective amendment to the Registration Statement. The Registration Statement as most recently amended has not become effective.

2. The Comp Services Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements therein not misleading. Among other things, the Registration Statement fails to disclose the identity of a control person and promoter of Comp Services. Additionally, the Registration Statement falsely states that Comp Services earned revenue for providing computer services, even though Comp Services has never earned any revenue.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to issue a stop order suspending the effectiveness of the registration statement, as agreed to in Comp Services' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 8(d) of the Securities Act that the effectiveness of the registration statement filed by Comp Services be, and hereby is, suspended.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9577 / April 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15853

In the Matter of

**THE REGISTRATION
STATEMENT OF COMP
SERVICES, INC.**

**ORDER INSTITUTING
PROCEEDINGS PURSUANT TO
SECTION 8(d) OF THE SECURITIES
ACT OF 1933, MAKING FINDINGS, AND
ISSUING STOP ORDER**

I.

A. On December 20, 2011, Comp Services, Inc. ("Comp Services" or "Respondent") filed a registration statement in connection with an initial public offering of 739,000 shares of common stock. The registration statement was amended seven times, most recently April 30, 2012. The registration statement as amended was declared effective on May 4, 2012. On October 17, 2013, November 27, 2013, and December 18, 2013, Comp Services filed a post-effective amendment to the registration statement. The registration statement as most recently amended has not become effective.

B. The Commission now deems it appropriate and in the public interest that proceedings pursuant to Section 8(d) of the Securities Act be, and they hereby are, instituted to determine whether a stop order should issue suspending the effectiveness of Comp Services' registration statement.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

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purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Section 8(d) of the Securities Act of 1933, Making Findings, and Issuing Stop Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. On December 20, 2011, Comp Services filed a Form S-1 registration statement in connection with an initial public offering of 739,000 shares of common stock (the "Registration Statement"). The Registration Statement was amended on January 27, 2012, February 22, 2012, March 14, 2012, April 9, 2012, April 23, 2012, April 26, 2012, and April 30, 2012. The registration statement as amended was declared effective on May 4, 2012. On October 17, 2013, November 27, 2013, and December 18, 2013, Comp Services filed a post-effective amendment to the Registration Statement. The Registration Statement as most recently amended has not become effective.

2. The Comp Services Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements therein not misleading. Among other things, the Registration Statement fails to disclose the identity of a control person and promoter of Comp Services. Additionally, the Registration Statement falsely states that Comp Services earned revenue for providing computer services, even though Comp Services has never earned any revenue.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to issue a stop order suspending the effectiveness of the registration statement, as agreed to in Comp Services' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 8(d) of the Securities Act that the effectiveness of the registration statement filed by Comp Services be, and hereby is, suspended.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Stein
Disapproved*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9578 \ April 25, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72032 \ April 25, 2014

In the Matter of

THE ROYAL BANK OF
SCOTLAND GROUP, PLC

ORDER UNDER RULE 405 OF THE
SECURITIES ACT OF 1933, GRANTING A
WAIVER FROM BEING AN INELIGIBLE
ISSUER

The Royal Bank of Scotland Group, plc (Company) has submitted a letter, dated March 27, 2014, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 (Securities Act). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry on January 14, 2014, of a Judgment against RBS Securities Japan Limited (RBS Japan). The Judgment finds RBS Japan guilty of felony wire fraud, in violation of Title 18, United States Code, Section 1343.

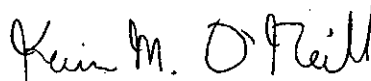
Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Title 18, United States Code, Section 1343 is included in Section 15(b)(4)(B) of the Exchange Act. Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the representations set forth in RBSG's March 27, 2014 request, and on other considerations, the Commission has determined that the Company has made a showing of good cause under Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act and that the Company should not be considered an ineligible issuer by reason of the entry of the Judgment.

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Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

A handwritten signature in cursive script that reads "Kevin M. O'Neill".

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72024 / April 25, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15857

In the Matter of

Shimul A. Shah,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Shimul A. Shah ("Respondent" or "Shimul").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter involves insider trading by Respondent in the securities of GSI Commerce, Inc. ("GSI") in advance of the March 28, 2011 announcement that eBay, Inc. ("EBAY") had agreed to acquire GSI.

2. On or about March 21, 2011, Respondent received material nonpublic information about the proposed acquisition of GSI from his brother, Suken Shah. Respondent knew or should have known that Suken had received the information as a result of a breach of fiduciary duty by an insider at GSI.

3. On or about March 24, 2011, Respondent traded on the basis of the information he had received. As a result of his improper use of the insider information, Respondent generated profits of approximately \$11,000.

4. On or about March 24, 2011, Respondent shared the material nonpublic information he had received with four other individuals (Individuals Y and Z, and Witnesses 1 and 2).

5. On or about March 25, 2011, Individuals Y and Z traded on the basis of the information they had received from Respondent. As a result of their improper use of the insider information provided by Respondent, Individuals Y and Z generated profits of approximately \$3,000 and \$32,000, respectively.

6. By virtue of his conduct, Respondent violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

7. *Shimul Shah*, age 40, resides in Cincinnati, OH. During the relevant time, Shimul was employed as a surgeon in Worcester, MA, and resided in Southborough, MA.

Other Relevant Persons

8. *GSI Commerce, Inc.*, an e-commerce company, was during the relevant time period headquartered in King of Prussia, PA. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by EBAY. GSI's common stock traded on the NASDAQ (former ticker symbol GSIC) and options on GSI's stock traded on multiple U.S. options exchanges.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

9. *Suken Shah*, age 44, resides in Wilmington, DE. During the relevant time period, Suken worked and resided in Wilmington, DE. Shimul and Suken Shah are brothers.

10. *Christopher Saridakis*, age 45, resides in Greenville, DE. During the relevant time period, Saridakis was a senior executive at GSI, worked in King of Prussia, PA and lived in Greenville, DE. During the relevant time, Suken and Saridakis were friends whose children attended the same school in Wilmington, DE.

11. *Individual Y*, age 42, resides in Shrewsbury, MA. During the relevant time, Individual Y worked and resided in Worcester, MA. During the relevant time, Shimul and Individual Y were friends who had previously attended their medical residency program together.

12. *Individual Z*, age 42, resides in Concord, MA. During the relevant time period, Individual Z worked in Cambridge, MA and resided in Concord, MA. During the relevant time, Shimul and Individual Z were friends who had previously attended their medical residency program together.

13. *Witness 1*, age 41, resides in Mendon, MA. During the relevant time, Witness 1 worked and resided in Massachusetts. During the relevant time, Shimul and Witness 1 were friends who had previously attended their medical residency program together.

14. *Witness 2*, age 47, resides in Shrewsbury, MA. During the relevant time, Witness 2 worked and resided in Worcester, MA. During the relevant time, Shimul and Witness 2 were friends who had previously attended their medical residency program together.

Facts

15. By January 30, 2011, representatives of GSI and EBAY began discussing a potential acquisition of GSI by EBAY. Discussions continued on January 31, 2011 and throughout February and March 2011. Negotiations culminated in the execution of a final agreement in the early morning of March 28, 2011.

16. Christopher Saridakis first learned of the possible acquisition of GSI by EBAY in mid-February 2011. Saridakis knew that the information about the possible acquisition of GSI by EBAY was material and nonpublic, and that he had an obligation to maintain the confidentiality of the information. Saridakis violated his fiduciary duty by disclosing this information to his friend, Suken.

17. Suken purchased shares of GSI for the first time on Monday, March 14, 2011, after learning of material nonpublic information about the proposed acquisition of GSI from Saridakis. Suken purchased additional shares of GSI on Monday, March 21, 2011.

18. On or around Monday, March 21, 2011, Suken spoke with Shimul by phone and conveyed material nonpublic information regarding GSI that he had learned from Saridakis, a friend and insider at GSI.

19. On Wednesday, March 23, 2011, Shimul transferred \$20,000 by check from his checking account to his brokerage account.

20. On Thursday, March 24, 2011, Shimul purchased 1100 GSI shares at a price of approximately \$18.91 per share, for a total price of \$20,801. Prior to March 24, 2011, Shimul had never traded in GSI securities.

21. On the evening of Thursday, March 24, 2011, Shimul attended a dinner with four friends with whom he had attended his residency years earlier. In addition to Shimul, Individuals Y and Z and Witnesses 1 and 2 attended the dinner. During this dinner, Shimul shared with Individuals Y and Z and Witnesses 1 and 2 the material nonpublic information about GSI that Suken had shared with him earlier that week. Shimul shared this information with the expectation that Individuals Y and Z and Witnesses 1 and 2 might trade based on the information he provided.

22. On Friday, March 25, 2011, Individual Y purchased 3,500 GSI April call options with a strike price of \$19. Individual Y purchased these options at \$0.90 per option, for a total purchase price of \$3,150. Individual Y purchased these options based on the information that Respondent shared at the dinner regarding the proposed acquisition of GSI. Prior to March 25, 2011, Individual Y had never purchased GSI shares or options.

23. On Friday, March 25, 2011, Individual Z purchased 300 GSI shares at a price of approximately \$19.33 per share, for a total price of \$5799. Individual Z purchased these shares based on the information that Respondent shared at the dinner regarding GSI. Prior to March 25, 2011, Individual Z had never purchased GSI shares.

24. Early in the morning on Monday, March 28, 2011, GSI and EBAY executed the merger agreement. Nasdaq halted trading in GSI shares at 9:22 a.m. that morning. At 10:05 a.m., GSI and EBAY announced that the companies had entered into a definitive agreement to merge, whereby EBAY would acquire GSI for \$29.25 per share, or a total consideration of approximately \$2.4 billion.

25. The market reacted significantly to the news. The closing last sale price of GSI on the day of the announcement was \$29.20, an increase of approximately 50.6% over the prior day's close. Trading volume on the day of the announcement was 42.6 million shares, compared to GSI's historical average daily volume of approximately 1.1 million shares.

26. On March 28, 2011, Shimul sold his GSI shares for \$29.10 per share, garnering profits of approximately \$11,209.

27. On March 28, 2011, Suken sold his GSI shares for profits of approximately \$9,838.

28. On March 28, 2011, Individual Y sold his GSI call options for profits of approximately \$31,777.

29. On March 28, 2011, Individual Z sold his GSI shares for profits of approximately \$2,913.

30. Shimul's purchase of GSI shares on March 24, 2011 was on the basis of material, nonpublic information about the proposed acquisition of GSI communicated by Suken. Shimul knew or should have known that Suken had received the information as a result of a breach of fiduciary duty by an insider at GSI. Saridakis obtained a personal benefit from tipping his friend, Suken.

31. The purchases of GSI shares by Individuals Y and Z were also on the basis of material, nonpublic information about the proposed acquisition of GSI, communicated by Shimul. Shimul intentionally communicated that information to Individuals Y and Z with the expectation that they might trade.

32. As a result of the conduct described above, Shimul violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

IV.

Undertakings

In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's attorney as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered the undertaking.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall pay to the United States Securities and Exchange Commission disgorgement of \$11,209.22, prejudgment interest of \$1,022.12, and a civil money penalty of \$22,418.44, for a total of \$34,649.78. Payment shall be made within 10 days of the entry of this Order. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Shimul A. Shah as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72022 / April 25, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15855

In the Matter of

AHARON R. YEHUDA,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Aharon R. Yehuda ("Yehuda" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter involves improper use of insider information by Yehuda in trading in the securities of GSI Commerce, Inc. ("GSI") in advance of the March 28, 2011 announcement that eBay, Inc. ("EBAY") had agreed to acquire GSI.
2. On or about March 27, 2011, Yehuda learned material nonpublic information about the acquisition of GSI from his friend, Oded Gabay ("Gabay"), that Yehuda knew or should have known had been disclosed in breach of a duty.
3. On March 28, 2011, Yehuda traded on the basis of material nonpublic information he had received from Gabay. As a result of his improper use of the insider information provided by Gabay, Yehuda generated trading profits of \$20,739.75.
4. By virtue of his conduct, Yehuda violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

5. *Aharon R. Yehuda*, age 53, resides in New York, NY. During the relevant time period, Yehuda operated family businesses in the diamond industry.

Other Relevant Parties

6. *GSI Commerce, Inc.*, an e-commerce company, was during the relevant time period headquartered in King of Prussia, PA. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by EBAY. GSI's common stock traded on the NASDAQ (former ticker symbol GSIC) and options on GSI's stock traded on multiple U.S. options exchanges.
7. *Oded Gabay* resides in the State of New York.
8. *Individual A* resides in the Commonwealth of Pennsylvania. Individual A was married to a GSI employee and resided in Pennsylvania during the relevant time period.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Facts

9. Individual A first learned of the possible acquisition of GSI by EBAY from her husband, a GSI employee who possessed material nonpublic information concerning GSI's operations and management, on or about January 30, 2011. Individual A knew that the information about the possible acquisition of GSI by EBAY was material and nonpublic, and that she had an obligation to maintain the confidentiality of the information.

10. Discussions continued between representatives of GSI and EBAY throughout February and March 2011. Negotiations culminated in the execution of a final agreement in the early morning of March 28, 2011.

11. On the weekend of March 26 and 27, 2011, Individual A and Gabay's wife met in New York City. Individual A told Gabay's wife about the upcoming acquisition of GSI and that news of the acquisition would be publicly announced on Monday, March 28, 2011. Gabay's wife understood that the information was material nonpublic information and that Individual A had an expectation that Gabay's wife would not disclose the information to others based on their close friendship and history of sharing confidences. Gabay's wife owed Individual A a duty of trust and confidence to keep confidential the material nonpublic information that she learned from her conversation with Individual A.

12. Following her meeting with Individual A, Gabay's wife shared the material nonpublic information regarding the upcoming GSI acquisition with Gabay.

13. After Gabay received the material nonpublic information about the upcoming acquisition of GSI, Gabay spoke with his friend, Yehuda. Gabay told Yehuda that Gabay's wife had learned from her friend, who was married to a GSI insider, about the upcoming acquisition of GSI and that the friend had said that she and her husband would be billionaires by Monday. Gabay discussed with Yehuda whether they should buy GSI stock together based on this information, but Yehuda declined.

14. However, on March 27, 2011, following his conversation with Gabay, Yehuda called his banker so as to place an order to purchase GSI shares. The next day, March 28, 2011, Yehuda purchased 2,200 GSI shares in pre-market trading at an average price of \$19.88 per share, for a total price of \$43,727.95. Yehuda purchased these shares based on the information he received from Gabay. Prior to March 28, 2011, Yehuda had never purchased GSI shares.

15. Early in the morning on Monday, March 28, 2011, GSI and EBAY executed the merger agreement. NASDAQ halted trading in GSI shares at 9:22 a.m. that morning based on pending news. At 10:05 a.m., GSI and EBAY announced that the companies had entered into a definitive agreement to merge, whereby EBAY would acquire GSI for \$29.25 per share, or a total consideration of approximately \$2.4 billion.

16. The market reacted significantly to the news. The closing last sale price of GSI on the day of the announcement was \$29.20, an increase of approximately 50.6% over the prior day's close. Trading volume on the day of the announcement was 42.6 million shares, compared to GSI's historical average daily volume of approximately 1.1 million shares.

17. On March 28, 2011, Yehuda sold his GSI shares for \$29.30 per share, garnering profits of \$20,739.75.

18. The purchase of GSI shares by Yehuda on March 28, 2011 was made on the basis of material nonpublic information about the upcoming acquisition of GSI, unlawfully tipped by Gabay. Gabay intentionally tipped that information to Yehuda and obtained a personal benefit in conferring a gift of confidential information on a friend. Yehuda knew or should have known that the information had been disclosed in breach of a duty.

19. As a result of the conduct described above, Yehuda violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

Undertakings

In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's attorney as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall pay to the Securities and Exchange Commission disgorgement of \$20,739.75, prejudgment interest of \$1,666.35, and a civil money penalty of \$20,739.75, for a total of \$43,145.85. Payment shall be made within 10 days of the entry of this Order. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Aharon R. Yehuda as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72023 / April 25, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15856

In the Matter of

Suken A. Shah,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Suken A. Shah ("Respondent" or "Suken").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purposes of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Exchange Act, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. Summary

1. This matter involves insider trading by Suken Shah in the securities of GSI Commerce, Inc. ("GSI") and tipping by Suken of two other traders in advance of the March 28, 2011 announcement that eBay, Inc. ("EBAY") had agreed to acquire GSI.

2. On or about March 11, 2011, Suken learned material nonpublic information about the proposed acquisition of GSI from Christopher Saridakis, a senior executive at GSI. Suken knew that Saridakis had learned this information through his position as a senior executive at GSI. Suken knew or should have known that Saridakis had disclosed this information in breach of a fiduciary duty owed to GSI.

3. On March 14, 2011, and on March 21, 2011, Suken traded on the basis of the information he had received from Saridakis. As a result of his improper use of the insider information provided by Saridakis, Suken generated profits of \$9,838.

4. On or about March 21, 2011, Suken shared the material nonpublic information he had received with his brother, Shimul Shah with the expectation that Shimul would trade.

5. On or about March 23, 2011, Suken shared the material nonpublic information he had received with his friend and business associate, Individual X with the expectation that Individual X would trade.

6. On March 24, 2011, Individual X traded on the basis of the information he had received from Suken. As a result of his improper use of the insider information, Individual X generated profits of \$609.

7. On March 24, 2011, Individual X shared the material nonpublic information he had received from Suken with three other individuals, one of whom improperly used the insider information to generate profits.

8. On March 24, 2011, Shimul traded on the basis of the material nonpublic information he had received from Suken. As a result of his improper use of the insider information, Shimul generated profits of \$11,209.

9. On March 24, 2011, Shimul shared the material nonpublic information he had received from Suken with four individuals, including Individuals Y and Z.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

10. On March 25, 2011, Individuals Y and Z traded on the basis of the information they had received from Shimul. As a result of their improper use of the insider information provided by Shimul, Individuals Y and Z generated trading profits of \$31,777 and \$2,913, respectively.

11. By virtue of his trading in GSI securities and his communications with Shimul and Individual X, Suken violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent

12. *Suken Shah*, age 44, resides in Wilmington, DE. During the relevant time, Suken was employed as a surgeon in the State of Delaware.

C. Other Relevant Persons

13. *GSI Commerce, Inc.*, an e-commerce company, was during the relevant time period headquartered in King of Prussia, PA. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by EBAY. GSI's common stock traded on the NASDAQ (former ticker symbol GSIC) and options on GSI's stock traded on multiple U.S. options exchanges.

14. *Christopher Saridakis* resides in Greenville, DE. During the relevant time period, Saridakis was a senior executive at GSI and resided in Greenville, DE.

15. *Shimul Shah* resides in Cincinnati, OH. During the relevant time, Shimul was employed as a surgeon in the Commonwealth of Massachusetts.

16. *Individual X* resides in the State of Delaware. During the relevant time period, Individual X worked in Wilmington, DE as a sales representative for a medical device distributor.

17. *Individual Y* resides in the Commonwealth of Massachusetts. During the relevant time, Individual Y worked as a surgeon in the Commonwealth of Massachusetts.

18. *Individual Z* resides in Concord, MA. During the relevant time period, Individual Z worked as a surgeon in Cambridge, MA and resided in Concord, MA.

D. Facts

19. By January 30, 2011, representatives of GSI and EBAY began discussing a potential acquisition of GSI by EBAY. Discussions continued on January 31, 2011 and throughout February and March 2011. Negotiations culminated in the execution of a final agreement in the early morning of March 28, 2011.

20. Christopher Saridakis first learned of the proposed acquisition of GSI by EBAY in mid-February 2011.

Tip from Saridakis to Respondent

21. On or about March 11, 2011, Saridakis attended an all-day meeting with representatives of EBAY to discuss the proposed acquisition. That same evening, Saridakis had a conversation with Suken, and informed Suken of the proposed acquisition of GSI.

22. Saridakis knew that the information about the proposed acquisition of GSI by EBAY was material and nonpublic, and that he had an obligation to maintain the confidentiality of the information. Saridakis tipped that information to his friend Suken in breach of a fiduciary duty owed to GSI and its shareholders and obtained a personal benefit.

23. Suken knew at the time that Saridakis was a senior executive at GSI. Suken knew that Saridakis received the information he communicated about the proposed acquisition through his position as a senior executive at GSI. Suken knew that the information about the proposed acquisition was not public and knew or should have known that the information was disclosed by Saridakis in breach of a duty.

Trading by Respondent

24. Suken purchased shares of GSI for the first time on Monday, March 14, 2011, on the basis of the material nonpublic information about the proposed acquisition of GSI communicated to him by Saridakis. Suken purchased 500 GSI shares at a price of approximately \$18.66, for a total price of \$9,330.

25. Suken purchased an additional 500 shares of GSI on Monday, March 21, 2011, at a price of approximately \$19.71, for a total price of \$9,854. Suken's second purchase of GSI shares was also on the basis of the material nonpublic information about the proposed acquisition of GSI communicated to him by Saridakis.

Tip from Respondent to Shimul

26. On or around Monday, March 21, 2011, Suken spoke with Shimul by phone and conveyed the material nonpublic information regarding GSI that Saridakis had tipped to him. Suken told Shimul that Suken had spoken with someone at GSI who had told him that GSI was about to be acquired. Suken informed Shimul that he believed the acquisition could be announced the following Monday. Suken shared this information with Shimul with the expectation that Shimul might trade on it.

Trading by Shimul

27. On Wednesday, March 23, 2011, Shimul transferred \$20,000 by check from his checking account to his brokerage account.

28. On Thursday, March 24, 2011, Shimul purchased 1100 GSI shares at a price of approximately \$18.91 per share, for a total price of \$20,801. Shimul purchased

these shares based on the information that Suken had communicated to him. Prior to March 24, 2011, Shimul had never traded in GSI securities.

Tipping by Shimul and Additional Downstream Trading

29. On the evening of Thursday, March 24, 2011, Shimul attended a dinner with four friends, including Individuals Y and Z. During this dinner, Shimul shared with the attendees the material nonpublic information about GSI that Suken had shared with him earlier that week.

30. On Friday, March 25, 2011, Individual Y purchased 3,500 GSI April call options with a strike price of \$19. Individual Y purchased these options at \$0.90 per option, for a total purchase price of \$3,150. Individual Y purchased these options based on Shimul's tip of the material nonpublic information regarding the proposed acquisition of GSI. Prior to March 25, 2011, Individual Y had never purchased GSI shares or options.

31. On Friday, March 25, 2011, Individual Z purchased 300 GSI shares at a price of approximately \$19.33 per share, for a total price of \$5799. Individual Z purchased these shares based on Shimul's tip of the material nonpublic information regarding the proposed acquisition of GSI. Prior to March 25, 2011, Individual Z had never purchased GSI shares.

Tip from Respondent to Individual X

32. On or about Wednesday, March 23, 2011, Suken shared with Individual X, a friend and business associate, the nonpublic material information that Saridakis had shared with him about GSI. Suken told Individual X that he had a friend within GSI who had told Suken that GSI was about to be acquired. Suken told Individual X that he believed the acquisition could be announced the following Monday and that Suken had recently purchased GSI securities. Suken shared this information with Individual X with the expectation that Individual X might trade on it.

Trading by Individual X

33. On Thursday, March 24, 2011, Individual X purchased 30 shares of GSI at a price of approximately \$19.03 per share, and another 30 shares at approximately \$19.10 per share, for a total price of approximately \$1,144. Individual X purchased these shares based on the information that Suken had communicated to him on the prior day. Prior to March 24, 2011, Individual X had never purchased GSI shares.

34. On March 24, 2011, Individual X shared the material nonpublic information he had received from Suken with three other individuals, one of whom improperly used the insider information to generate profits.

Merger Announcement and Market Reaction

35. Early in the morning on Monday, March 28, 2011, GSI and EBAY executed the merger agreement. NASDAQ halted trading in GSI shares at 9:22 a.m. that morning based on pending news. At 10:05 a.m., GSI and EBAY announced that the companies had entered into a definitive agreement to merge, whereby EBAY would acquire GSI for \$29.25 per share, or a total consideration of approximately \$2.4 billion.

36. The market reacted significantly to the news. The closing last sale price of GSI on the day of the announcement was \$29.20, an increase of approximately 50.6% over the prior day's close. Trading volume on the day of the announcement was 42.6 million shares, compared to GSI's historical average daily volume of approximately 1.1 million shares.

Sales by Traders and Profits Generated

37. On March 28, 2011, Suken sold his GSI shares for \$29.02 per share, generating profits of approximately \$9,838.

38. On March 28, 2011, Shimul sold his GSI shares for \$29.10 per share, generating profits of approximately \$11,209.

39. On April 6, 2011, Individual X sold his GSI shares for \$29.22 per share, generating profits of approximately \$609.

40. On March 28, 2011, Individual Y sold his GSI call options for profits of approximately \$31,777.

41. On March 28, 2011, Individual Z sold his GSI shares for profits of approximately \$2,913.

Basis for Trading and Scienter

42. Suken's purchases of GSI shares on March 14 and March 21, 2011 were on the basis of material, nonpublic information about the proposed acquisition of GSI, communicated by Saridakis, who obtained a personal benefit. Suken knew or should have known that Saridakis received the information through his position as a senior executive at GSI, and breached his fiduciary duty when he shared that information with Suken.

43. Shimul's purchase of GSI shares on March 24, 2011 was on the basis of material, nonpublic information about the proposed acquisition of GSI communicated by Suken, who obtained a personal benefit.

44. Individual X's purchase of GSI shares on March 24, 2011 was on the basis of material, nonpublic information about the proposed acquisition of GSI communicated by Suken, who obtained a personal benefit.

E. Violations

45. As a result of his trading in GSI securities and his communications with Shimul and Individual X, Respondent violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

IV.

Undertakings

In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's attorney as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered the undertakings.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall pay to the United States Securities and Exchange Commission disgorgement of \$10,446, prejudgment interest of \$1,007, and a civil money penalty of \$64,965, for a total of \$76,418. Payment shall be made within 10 days of the entry of this Order. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or



(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Suken A. Shah as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72021 / April 25, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15854

In the Matter of

ODED GABAY,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Oded Gabay ("Gabay" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter involves insider trading by Gabay in the securities of GSI Commerce, Inc. ("GSI") in advance of the March 28, 2011 announcement that eBay, Inc. ("EBAY") had agreed to acquire GSI.

2. On the weekend of March 26 and 27, 2011, Gabay's wife learned material nonpublic information about the acquisition of GSI from an individual with whom she had a relationship of trust and confidence ("Individual A"). Gabay's wife misappropriated the material nonpublic information about the acquisition of GSI in breach of the duty of trust and confidence she owed to Individual A when she disclosed the information to her husband, Gabay. Gabay knew or should have known that his wife had unlawfully misappropriated the material nonpublic information in breach of her duty of trust and confidence owed to Individual A.

3. On or about March 28, 2011, Gabay traded on the basis of the material nonpublic information he had received. As a result of his improper use of the insider information, Gabay generated trading profits of \$23,615.

4. On or about March 27, 2011, Gabay shared the material nonpublic information he had received with his friend, Individual B.

5. On March 28, 2011, Individual B traded on the basis of the material nonpublic information he had received from Gabay. As a result of his improper use of the insider information provided by Gabay, Individual B generated trading profits of \$20,739.75.

6. By virtue of his conduct, Gabay violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

7. *Oded Gabay*, age 39 resides in New York, NY. During the relevant time period, Gabay was a hairdresser and co-owner of two Lovella hair salons in New York City.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Parties

8. *GSI Commerce, Inc.*, an e-commerce company, was during the relevant time period headquartered in King of Prussia, PA. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by EBAY. GSI's common stock traded on the NASDAQ (former ticker symbol GSIC) and options on GSI's stock traded on multiple U.S. options exchanges.

9. *Individual A* resides in the Commonwealth of Pennsylvania. Individual A was married to a GSI employee and resided in Pennsylvania during the relevant time period.

10. *Individual B* resides in the State of New York. During the relevant time period, Individual B operated family businesses in the diamond industry.

Facts

11. Individual A first learned of the possible acquisition of GSI by EBAY from her husband, a GSI employee who possessed material nonpublic information concerning GSI's operations and management, on or about January 30, 2011. Individual A knew that the information about the possible acquisition of GSI by EBAY was material and nonpublic, and that she had an obligation to maintain the confidentiality of the information.

12. Discussions continued between representatives of GSI and EBAY throughout February and March 2011. Negotiations culminated in the execution of a final agreement in the early morning of March 28, 2011.

13. Individual A and Gabay's wife, who had been friends since Gabay's wife was in college, had a long-standing relationship of trust and confidence. Through the years of their friendship, the two would often share confidences about their children, their marriages and their personal lives.

14. Gabay and his wife were friends with Individual A and her husband for several years prior to 2011 and knew of GSI. Gabay purchased GSI shares in January and early March 2011.

15. On the weekend of March 26 and 27, 2011, Gabay's wife and Individual A met in New York City. Gabay's wife and Individual A brought their children and discussed their personal lives including the reasons why Individual A was in New York City, which involved negotiations over the acquisition of GSI. Individual A told Gabay's wife about the upcoming acquisition of GSI and that news of the acquisition would be publicly announced on Monday, March 28, 2011. Gabay's wife understood that the information was material nonpublic information and that Individual A had an expectation that she would not disclose the information to others based on their close friendship and history of sharing confidences. Gabay's wife owed Individual A a duty of trust and

confidence to keep confidential the material nonpublic information that she learned from her conversation with Individual A.

16. Following her meeting with Individual A, Gabay's wife shared the material nonpublic information regarding the upcoming GSI acquisition with Gabay.

17. After receiving the material nonpublic information about the upcoming acquisition of GSI, Gabay spoke with his friend, Individual B. Gabay told Individual B that his wife had learned from her friend, who was married to a GSI insider, about the upcoming acquisition of GSI and that the deal would be announced on Monday. Gabay and Individual B discussed whether they should buy GSI stock based on this information.

18. On March 28, 2011, Individual B purchased 2,200 GSI shares in pre-market trading at an average price of \$19.88 per share, for a total price of \$43,727.95. Individual B purchased these shares based on the information he received from Gabay. Prior to March 28, 2011, Individual B had never purchased GSI shares.

19. That same morning, March 28, 2011, Gabay purchased 2,500 GSI shares in pre-market trading at a price of \$19.98 for a total purchase price of \$49,960. Gabay purchased these shares based on the misappropriated material nonpublic information that his wife had communicated to him about the upcoming acquisition of GSI.

20. Early in the morning on Monday, March 28, 2011, GSI and EBAY executed the merger agreement. NASDAQ halted trading in GSI shares at 9:22 a.m. that morning based on pending news. At 10:05 a.m., GSI and EBAY announced that the companies had entered into a definitive agreement to merge, whereby EBAY would acquire GSI for \$29.25 per share, or a total consideration of approximately \$2.4 billion.

21. The market reacted significantly to the news. The closing last sale price of GSI on the day of the announcement was \$29.20, an increase of approximately 50.6% over the prior day's close. Trading volume on the day of the announcement was 42.6 million shares, compared to GSI's historical average daily volume of approximately 1.1 million shares.

22. On March 28, 2011, Individual B sold his GSI shares for \$29.30 per share, garnering profits of \$20,739.75.

23. On March 28, 2011, Gabay sold the 2,500 GSI shares he had purchased earlier that day and garnered \$23,615 in profits.

24. Gabay's purchase of GSI shares on March 28, 2011 was on the basis of material nonpublic information about the upcoming acquisition of GSI unlawfully misappropriated from Individual A. Gabay knew or should have known that his wife had disclosed the material nonpublic information in breach of her duty of trust and confidence to Individual A.

25. The purchase of GSI shares by Individual B on March 28, 2011 was also on the basis of material nonpublic information about the upcoming acquisition of GSI, unlawfully tipped by Gabay. Gabay intentionally tipped that information to Individual B and obtained a personal benefit.

26. As a result of his conduct described above, Gabay violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

Undertakings

In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's attorney as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered these undertakings and the cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall pay to the Securities and Exchange Commission disgorgement of \$23,615, prejudgment interest of \$1,207.37, and a civil money penalty of \$22,177 for a total of \$46,999.37. Payment shall be made within 10 days of the entry of this Order. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Oded Gabay as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

C. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of \$22,177 based upon his cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to Respondent, petition the Commission to reopen this matter and seek an order directing that Respondent pay a civil money penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether he knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Pinowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9579 / April 28, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72034 / April 28, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3825 / April 28, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31031 / April 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15858

In the Matter of

STANLEY JONATHAN
FORTENBERRY (A/K/A S.J.
FORTENBERRY, JOHN
FORTENBERRY, AND
JOHNNY FORTENBERRY),

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES
ACT OF 1933, SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
SECTIONS 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940
AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Stanley Jonathan Fortenberry (a/k/a S.J. Fortenberry, John Fortenberry, and Johnny Fortenberry) ("Respondent" or "Fortenberry").

II.

After an investigation, the Division of Enforcement alleges that:

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A. SUMMARY

1. Respondent Fortenberry is a recidivist securities laws violator. Notwithstanding cease-and-desist orders issued by the Pennsylvania Securities Commission and the Texas State Securities Board, starting in 2010, Fortenberry solicited investors for his Premier Investment Fund L.P. ("Premier"), which he marketed as a vehicle to invest in various country music-themed social media and entertainment ventures.

2. Fortenberry, orally and in the Premier offering materials that he drafted and distributed, guaranteed to investors returns of at least 12% per annum, and he provided at least one investor with monthly account statements showing falsely that the fund was meeting its projections and that its investments were turning a profit.

3. Based on his representations, the Premier offering materials, and account statements, Fortenberry raised hundreds of thousands of dollars for Premier, and he actively worked to raise millions more.

4. In reality, however, Fortenberry looted the fund. Unbeknownst to his investors and those he solicited, Fortenberry withdrew approximately half of the money entrusted to him. Despite the fact that Premier had no profits—indeed, no income whatsoever—Fortenberry wrote checks to himself for tens of thousands of dollars in "management fees," and he also spent the fund's assets on his living expenses, mortgage, utilities, credit card bills, personal travel, and purchases at various gas stations and liquor stores.

5. To facilitate his fraud and to impede the scrutiny of the investors in the fund, Fortenberry also kept almost no business records for Premier—despite explicit representations that the fund would maintain a "capital account" for each investor and that Fortenberry would "use generally accepted accounting principles . . . [to] keep[Premier's] books and records."

6. While Fortenberry did invest a portion of Premier's assets, Premier's investments never turned a profit, and all of Premier's assets are now, for all intents and purposes, gone.

B. RESPONDENT

7. Stanley Jonathan Fortenberry (also known as "S.J. Fortenberry," "John Fortenberry," and "Johnny Fortenberry"), age 48, is the General Partner of Premier Investment Fund L.P. ("Premier"), a Tennessee limited partnership and pooled investment vehicle. As the General Partner of Premier, Fortenberry held exclusive responsibility for soliciting investments, communicating with investors, and making investment decisions on behalf of Premier. Fortenberry resides in San Angelo, Texas.

8. As the General Partner of Premier and as an investment adviser, Fortenberry owed to Premier fiduciary duties, including the duty to act at all times in the best interest of the fund.

9. Fortenberry has twice previously been subjected to cease-and-desist orders in connection with securities fraud. In 2004, both the Pennsylvania Securities Commission and the Texas State Securities Board ordered Fortenberry to cease and desist from selling unregistered securities.

10. Specifically, the Texas regulator found in its order, and Fortenberry consented, that Fortenberry had "intentionally failed" to disclose the following material facts:

- (A) Information regarding the assets, liabilities, profits, losses, cash flow, and operating history of the issuer sufficient to enable a prospective investor to make an informed decision regarding the risks associated with the offering.
- (B) The specific risks associated with [the] investment . . . , including the risk that a working interest owner may be liable for costs or claims in excess of the amount of his or her investment.
- (C) Respondent Fortenberry was convicted of theft in cause [sic] number 309,091 in the County Court at Law No. 7, Travis County, Texas on February 2, 1990.
- (D) Respondent Fortenberry filed for Chapter 13 bankruptcy in the United States Bankruptcy Court, Northern District of Texas, Lubbock Division, on August 3, 1992, in case number 92-50525, and said bankruptcy was dismissed on March 21, 1994 by motion of the Trustee.
- (E) Respondent Fortenberry filed for Chapter 13 bankruptcy in the United States Bankruptcy Court, Northern District of Texas, Lubbock Division, on December 16, 1993, in case number 93-50785, and said bankruptcy was dismissed on September 30, 1994 by motion of the Trustee.

11. The Texas State Securities Board then issued the following Order against Fortenberry as a result of his conduct:

- 1. It is therefore ORDERED that [Fortenberry] CEASE AND DESIST from offering for sale any security in Texas until the security is registered with the Securities Commissioner or is offered for sale pursuant to an exemption from registration under the Texas Securities Act.



2. It is further ORDERED that [Fortenberry] immediately CEASE AND DESIST from acting as [a] securities dealer[] or agent[] in Texas until [Fortenberry is] registered with the Securities Commissioner or [is] acting pursuant to an exemption from registration under the Texas Securities Act.
3. It is further ORDERED that [Fortenberry] CEASE AND DESIST from engaging in any fraud in connection with the offer for sale of any security in Texas.

12. In participating in the conduct set forth below, Fortenberry engaged in conduct that is nearly identical to that which formed the basis of the Texas cease-and-desist order.

13. In 2010 and 2011, Fortenberry intentionally used the name "John"—a misspelling of his middle name—when soliciting investors and drafting Premier's partnership agreement.

14. On information and belief, Fortenberry used the name "John" so that prospective investors would be less likely to connect him to the Texas and Pennsylvania cease-and-desist orders, which are readily available on the Internet, or to learn of his prior felony conviction and multiple bankruptcy filings.

C. OTHER RELEVANT PERSONS AND ENTITIES

1. *Premier Investment Fund L.P.*

15. Premier Investment Fund L.P. ("Premier") is a Tennessee limited partnership formed by Fortenberry in 2010. Premier is a pooled investment vehicle. Premier's principal place of business is in San Angelo, Texas. Premier is not registered with the Commission.

16. Fortenberry is the General Partner of Premier. Premier also has two limited partners by virtue of their investment in Premier.

17. Currently, Premier has no cash or other assets, except for a small equity stake in a start-up, entertainment and social media company. The value, if any, of Premier's equity stake is unknown.

2. *Victim 1*

18. Victim 1 is a resident of Kings Park, New York. On September 13, 2010 and November 16, 2010, Victim 1 invested a total of \$200,000 in Premier, in two lump sums of \$100,000.

19. By virtue of his investments, Victim 1 is a limited partner of Premier.

3. *Victim 2*

20. Victim 2 is a resident of San Angelo, Texas. Between August 3, 2010 and March 8, 2011, Victim 2 invested \$100,000 in Premier, in what were, largely, monthly installments. During the period of his investment in Premier, Victim 2 suffered from the effects of a stroke and chronic Lyme disease, which severely impaired his memory, cognition, and decision-making abilities.

21. By virtue of his investments, Victim 2 is a limited partner of Premier.

D. FORTENBERRY MADE MATERIAL FALSE STATEMENTS

22. The instant fraud began in March 2010 when Fortenberry contacted a prominent manager of country music talent (the "Manager") and offered to raise money for the Manager's new entertainment and social media company ("Company A"), which was to fund, among other things, a country music-themed social media website ("Country Music Website").

23. Following this initial contact, Fortenberry created and included in Premier's offering materials what he purported was a business plan for Country Music Website. Fortenberry used this business plan to inform prospective limited partners of one of the ways that they would make money on investments in Premier. He then began contacting potential investors, including Victim 1, and encouraged them to invest in Premier, Fortenberry's fund which would eventually invest in Country Music Website via Company A. Fortenberry touted his ability to invest in the entertainment and country music industries, and he frequently arranged for potential investors to meet the Manager.

24. The Manager never authorized the Country Music Website business plan's inclusion in the Premier offering documents. Fortenberry prepared these documents without the Manager's knowledge. Upon learning of the materials, the Manager objected and instructed Fortenberry to stop using the materials.

25. The business plan and other offering documents contain numerous materially false and misleading statements, specifically regarding the risks associated with the enterprise and its likely return for Premier investors. For example, the business plan that Fortenberry created and distributed to Premier's potential investors states as follows:

[Country Music Website] will average thirty dollars per month per member. We are confident that we will achieve one million members by August 15, 2012. Consequently, [Country Music Website] will be grossing thirty million dollars per month. We expect our cost, at that point, to remain under two million dollars monthly, leaving a profit of twenty eight million dollars monthly.

If you invest now, we will pay you twelve percent (12%) per annum. Repayment of principal and interest will be paid back in three years, along with you keeping your equity

stake in the holdings. Most importantly, our investors will receive twelve and one half percent of twenty eight million dollars, which is three and one half million dollars divided by our one hundred investors. Thus, each investor will be paid thirty five thousand dollars per month for the rest of his or her life.

26. Fortenberry knew or was reckless in not knowing that his written and oral representations regarding Premier's actual and projected performance were false and misleading.

27. In the limited partnership agreement he created, Fortenberry also misrepresented to Premier's investors and prospective investors that the fund did and would keep accurate and appropriate books and records:

C. . . . Each partner shall have a capital account that includes invested capital plus that partner's allocations of net income, minus that partner's allocation of net loss and share of distributions. . . .

F. The Company shall use generally accepted accounting principles, as amended from time to time, in keeping its books and records, and its fiscal year shall be a calendar year. The general partner shall make any tax election necessary for completion of the partnership tax return.

28. A full set of financial statements prepared in accordance with generally accepted accounting principles ("GAAP") consist of a balance sheet, income statement, statement of comprehensive income, statement of cash flows, and accompanying footnotes to the financial statements. GAAP financial statements and footnotes also require certain treatment, presentation, and disclosure relating to various transactions and account balances.

29. In reality, Fortenberry made no attempt to comply with the recordkeeping requirements of the partnership agreement. He never kept capital accounts, balance sheets, income statements, statements of comprehensive income, statements of cash flows, or accompanying footnotes for Premier. Premier also never filed a tax return or prepared the papers necessary for Premier or its investors to prepare their returns. And, the account statements Fortenberry sent to one investor were materially false and misleading.

30. Fortenberry also "lost," destroyed, and otherwise failed to maintain documentation relating to Premier and his activities as general partner. His failure to maintain the financial and business records of Premier was not conducive to accurate, complete, and reliable financial reporting under GAAP.

31. Again, Fortenberry knew or was reckless in not knowing that his representations regarding Premier's recordkeeping were false and misleading.

32. Fortenberry provided these materially false and misleading Premier offering materials to Victim 1 and Victim 2.

33. Fortenberry also made numerous oral misrepresentations to Victim 1. For example, Fortenberry told Victim 1 that his entire capital investment in Premier would be used by Premier to invest in Company A, and that Fortenberry's compensation would be limited to an equity stake in Premier. Fortenberry led Victim 1 to believe that Premier would have almost no expenses of its own. Fortenberry never revealed that he intended to and did divert a substantial portion of Victim 1's investment for his own benefit.

34. As a result of Fortenberry's materially false and misleading statements, Victim 1 invested a total of \$200,000 in Premier through two investments of \$100,000 each.

35. Fortenberry also preyed on those most vulnerable to fraud: the sick and elderly.

36. Fortenberry met Victim 2, a retiree, through a 12-step program in which both participated. Victim 2 suffered from numerous physical and mental ailments, including the effects of a stroke and chronic Lyme disease, which severely impaired his memory, cognition, and decision-making abilities.

37. Fortenberry knew of Victim 2's ailments, as Victim 2 spoke openly about them at various meetings of the 12-step program attended by Fortenberry.

38. Fortenberry convinced Victim 2 to invest in Premier through materially false and misleading information. For example, Fortenberry told Victim 2 that Victim 2's entire investment would be used to invest in the entertainment industry, and Fortenberry never revealed that he intended to and did divert a substantial portion of Victim 2's investment for his own benefit.

39. On August 3, 2010, Victim 2 provided Fortenberry with a check, written from Victim 2's retirement funds, with the understanding that the funds would be invested. Unbeknownst to Victim 2, however, Fortenberry immediately deposited Victim 2's check into Fortenberry's personal bank account and never transferred the proceeds to Premier.

40. To entice Victim 2 to invest additional capital on a monthly basis, Fortenberry sent Victim 2 materially false and misleading monthly account statements, and provided other false updates concerning Premier's investments and supposed profitability. For example, within a month of Victim 2's initial investment, Fortenberry represented to Victim 2 that Premier had invested in a movie production company when, in fact, Premier never made any such investment.

41. Fortenberry also created and sent to Victim 2 monthly account statements that gave the appearance that the fund's investments were generating a profit and that Victim 2's investment in Premier was, in turn, profitable. The fund, however, never generated a profit—it has never received a single dollar of return on its investment.

42. As intended, these false statements about Premier's investments and profits induced Victim 2 to continue to make monthly investments in Premier. Over the course of several months, Victim 2 invested approximately \$100,000 in Premier.

43. Tellingly, Fortenberry did not send these false and misleading monthly account statements to Victim 1, who purchased a full limited partnership interest at the time of each of his investments and who requested, but never received, complete financial statements from Fortenberry.

44. As with Fortenberry's prior state securities laws violation, Fortenberry misrepresented and failed to provide to Premier's investors (a) "information regarding the assets, liabilities, profits, losses, cash flow, and operating history of the issuer sufficient to enable a prospective investor to make an informed decision regarding the risks associated with the offering," (b) that Fortenberry had been convicted of theft, and (c) that Fortenberry had twice filed for bankruptcy. Fortenberry also failed to disclose to Premier's investors that he was subject to two cease-and-desist orders resulting from prior state securities laws violations.

45. Based on Fortenberry's written and oral misrepresentations, two investors invested a total of \$300,000 in Premier.

46. Fortenberry was the sole investment adviser for Premier, and after obtaining these investment proceeds, enjoyed unfettered control over Premier and its bank account. When managing Premier and its assets, Fortenberry completely ignored corporate formalities, routinely commingling Premier's funds with his own.

E. FORTENBERRY LOOTED THE FUND

47. In addition to his misrepresentations regarding the fund's prospects and recordkeeping, Fortenberry also falsely told investors and prospective investors in Premier that his compensation for his work managing Premier's investments would be solely in the form of an equity stake in Premier and a concomitant share in Premier's profits.

48. Fortenberry repeated this misrepresentation to Premier's investors and prospective investors in Premier's partnership agreement, which purported to give Fortenberry 100 partnership units out of a possible 199 units and 50% of Premier's net income:

- A. The undersigned acknowledges that in consideration for his pre-formation and formation activities for the benefit of the Company John Fortenberry received hereby at the time of the Company's formation 100 Units of the Company, and was hereby appointed general partner of the Company. . . .
- D. After tax net income, net loss, and voting power of the Company shall be allocated as follows:

1. 50 percent to the general partner.
2. 50 percent to the limited partners, allocated according to their percentage of the total limited partnership capital accounts.

49. While the partnership agreement authorized Fortenberry to incur, on behalf of Premier, "reasonable administrative expenses," which could include "salaries," nothing in the partnership agreement permitted Fortenberry to use Premier's assets for his unfettered personal use and benefit. And, in any event, Fortenberry never disclosed to his investors the payment of any "salary" or "reasonable administrative expenses" to him.

50. Moreover, irrespective of any specific provision of the partnership agreement, as the General Partner of Premier and as an investment adviser, Fortenberry owed to Premier fiduciary duties, including the duty to act at all times in the best interest of the fund.

51. Notwithstanding these representations and duties, upon receiving investments from Victims 1 and 2, Fortenberry proceeded to loot the fund. Against his prior representations, he took over a hundred and forty thousand dollars in "management fees" and in the form of personal expenses that he charged to the fund.

52. Despite representing to investors that his compensation would be solely in the form of an equity stake in Premier and a concomitant share in Premier's profits, Fortenberry never disclosed to Premier or its investors that he intended to or, in fact, paid himself "management fees," and the partnership agreement makes no mention whatsoever of such compensation. Nevertheless, between September 2010 and March 2011, Fortenberry wrote "management fee" checks to himself in the amount of approximately \$68,550—over 22% of the total amount with which he was entrusted. Even assuming, counterfactually, that such remuneration was authorized by the partnership agreement, the amount here far exceeded any reasonable or foreseeable management fee.

53. Fortenberry also never disclosed to Premier's investors that he intended to and, in fact, did use the money invested in Premier for his unfettered personal use and benefit, yet Fortenberry also took approximately \$79,950 of Premier and its investors' money for what appear to be entirely personal expenses and cash withdrawals. These intentions and acts contradicted his representations that Premier's assets would be used to make investments in companies, with a focus on the entertainment industry.

54. Fortenberry used Premier's funds to pay for travel and concert tickets for his family members, personal credit card payments, clothing, jewelry, groceries, cable bills, utilities, insurance, unknown expenditures via PayPal, a Netflix subscription, car repairs and maintenance, gasoline, convenience and liquor store purchases, and trips to various restaurants and coffee shops.

55. Fortenberry's failure to maintain accurate books and records in accordance with GAAP facilitated the concealment of these expenses from investors and regulators.

Indeed, on information and belief, that was the intended purpose of Fortenberry's conduct in this regard.

56. In all, Fortenberry took at least \$148,500 of investor proceeds in undisclosed management fees, personal expenses, and cash withdrawals, none of which was disclosed to Premier's investors. Indeed, instead of using these assets of Premier for its investment purposes, he acted for his self-interests and misappropriated the assets for his own personal benefit.

57. On information and belief, Fortenberry invested the balance of the Premier money entrusted to him in Company A for, among other things, its Country Music Website, so that he could continue to represent that he was associated with the Manager and the Country Music Website and, as such, continue his fraud.

F. VIOLATIONS

58. As a result of the conduct described above, Fortenberry willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

59. As a result of the conduct described above, Respondent also willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent and deceptive conduct by an investment adviser with respect to any client or prospective client, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit making an untrue statement of a material fact or omitting any material fact to any investor or prospective investor in a pooled investment vehicle and engaging in any act, practice, or course of business that is fraudulent or deceptive with respect to any investor or prospective investor in a pooled investment vehicle.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. what, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and 203(j) of the Advisers Act;

C. what, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act; and

D. whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a)(2) of the Exchange Act, and Section 203(i) of the Advisers Act, and whether Respondent should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Section 21C(e) of the Exchange Act, and Section 203(j) and 203(k)(5) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72043 / April 29, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15859

In the Matter of

**Assured Equities IV Corp.,
Beach First National Bancshares, Inc.,
Norquest Acquisition Corp.,
SAE Acquisitions, Inc.,
Unity Holdings, Inc.,
Valiant Healthcare, Inc. (n/k/a Valiant
ACMS, Inc.), and
Winrock International, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Assured Equities IV Corp., Beach First National Bancshares, Inc., Norquest Acquisition Corp., SAE Acquisitions, Inc., Unity Holdings, Inc., Valiant Healthcare, Inc. (n/k/a Valiant ACMS, Inc.), and Winrock International, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Assured Equities IV Corp. (CIK No. 1447256) is a dissolved Florida corporation located in Talmo, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Assured Equities is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it

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filed a Form 10-K for the period ended May 31, 2010, which reported a net loss of \$5,150 for the prior twelve months.

2. Beach First National Bancshares, Inc. (CIK No. 949228) is a South Carolina corporation located in Myrtle Beach, South Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Beach First is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of over \$24 million for the prior nine months. As of February 4, 2014, the company's stock (symbol "BFNBQ") was traded on the over-the-counter markets. On May 14, 2010, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of South Carolina, and the case was still pending as of April 21, 2014.

3. Norquest Acquisition Corp. (CIK No. 14411167) is a forfeited Delaware corporation located in Durham, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Norquest is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2009, which reported a net loss of \$3,134 from the company's January 11, 2008 inception to December 31, 2009.

4. SAE Acquisitions, Inc. (CIK No. 1451049) is a dissolved Florida corporation located in Hallandale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SAE Acquisitions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of over \$1.9 million for the prior six months.

5. Unity Holdings, Inc. (CIK No. 1054929) is a dissolved Georgia corporation located in Cartersville, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Unity Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended September 30, 2009, which reported a net loss of over \$13 million for the prior nine months.

6. Valiant Healthcare, Inc. (n/k/a Valiant ACMS, Inc.) (CIK No. 1449491) is a void Delaware corporation located in Coral Springs, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Valiant is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009.

7. Winrock International, Inc. (CIK No. 1433561) is a forfeited Delaware corporation located in Canton, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Winrock is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$3,134 from its February 9, 2009 inception to September 30, 2009.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72058 / April 30, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3826 / April 30, 2014

INVESTMENT COMPANY ACT OF 1940

Release No. 31035 / April 30, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-15526

In the Matter of

GEORGE B. FRANZ III

and

RUBY CORPORATION,

Respondents.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS AND
A CEASE-AND-DESIST ORDER
PURSUANT TO SECTIONS 203(e), (f), AND
(k) OF THE INVESTMENT ADVISERS ACT
OF 1940, SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, AND SECTION
9(b) OF THE INVESTMENT COMPANY
ACT OF 1940

I.

On September 26, 2013, the Securities and Exchange Commission ("Commission" or "SEC") instituted public administrative and cease-and-desist proceedings pursuant to Sections 203(e), (f), and (k) of the Investment Advisers Act of 1940 ("Advisers Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against George B. Franz III and Ruby Corporation.

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II.

Respondents have submitted a joint Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), (f), and (k) of the Investment Advisers Act of 1940, Section 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940 ("Order"), as set forth below.¹

III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

SUMMARY

This matter arises out of the theft of advisory client funds and a cover-up by the perpetrator's father and supervisor. From 2007 through 2011, Andrew Franz stole over \$490,000 from about 50 clients of Ruby Corporation ("Ruby"), an investment adviser registered with the Commission. Andrew Franz also stole another \$350,000 from Ruby itself and \$800,000 from a Franz family trust. Andrew Franz issued numerous bogus advisory fee requests for Ruby client accounts and then diverted the resulting excess fees to his personal bank accounts or to Ruby's bank accounts to conceal the firm's dwindling income. Andrew also made fraudulent redemption requests from client accounts and diverted those funds. George Franz, Andrew's father and the sole owner and principal of Ruby, learned of numerous instances of misconduct and thefts by Andrew from 2007 through early 2011 but did nothing to stop him, even engaging in a cover-up in which he defrauded his clients and lied to the SEC during its investigation, including by providing false documents to the SEC.

RESPONDENTS

1. George B. Franz III. George Franz founded Ruby Corporation, a registered investment adviser located in Beachwood, Ohio, in 2000 and is its sole owner and

¹ The findings herein are made pursuant to the Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

principal. George Franz had supervisory responsibility over Andrew Franz from at least 2006 through 2011. George Franz, age 71, is a resident of Moreland Hills, Ohio and Marco Island, Florida. George Franz received his Series 6 license in 1982 and was associated with various brokerage firms from 1991 until September 2006, when he ceased to be associated with any brokerage firm.

2. Ruby Corporation. Ruby Corporation ("Ruby") is an Ohio corporation with its principal place of business in Beachwood, Ohio. Ruby is registered with the Commission as an investment adviser. Since 2007, Ruby has had two or three part-time employees on its staff in addition to its owner George Franz. As of December 2012, Ruby had 99 clients with assets under management of \$21 million. Ruby's clients are typically middle-age and retirement-age individuals in the Cleveland, Youngstown, and Dayton, Ohio areas. Ruby's client accounts are discretionary and are invested primarily in mutual funds and variable annuities.

OTHER RELEVANT INDIVIDUAL

3. Andrew J. Franz. Andrew Franz, age 42, is an inmate at the Federal Correctional Institution in Ashland, Kentucky, and is formerly a resident of Aurora, Ohio. Andrew Franz received his Series 6 license in 2002 and was a registered representative with various broker-dealers until March 2011. Andrew Franz was a paid employee of Ruby from 2002 until 2007, after which he ceased receiving a salary but continued to manage Ruby's operations, specifically the billing of management fees on client accounts. At all times until his termination from Ruby in 2011, Andrew Franz maintained an office at Ruby.

4. In March 2012, the SEC filed an emergency action against Andrew Franz in U.S. District Court, alleging among other things that he had misappropriated funds from Ruby clients by issuing fraudulent management fee requests, and obtained an emergency asset freeze and a permanent injunction. *SEC v. Andrew J. Franz*, 5:12-cv-00642 (N.D. Ohio). After an evidentiary hearing, in June 2012 the Court made findings of fact, held that Andrew Franz had violated the antifraud provisions of the Exchange Act and the Advisers Act, and entered a permanent injunction against further violations of those provisions. On March 15, 2013, the Commission barred Andrew Franz from the securities industry by declaring as final an initial decision by ALJ Cameron Elliot dated January 18, 2013.

5. On July 23, 2013, Andrew Franz pled guilty to charges of wire fraud, tax fraud, and violations of Section 10(b) of the Exchange Act and Sections 206(1) and (2) of the Advisers Act. *U.S. v. Andrew J. Franz*, 1:13-cr-00331 (N.D. Ohio). On October 23, 2013, Andrew Franz was sentenced to 57 months imprisonment and ordered to pay

\$357,069 in restitution and an additional \$245,352 (plus penalties and interest) to the IRS for his income tax violations.

FACTS

Andrew Franz misappropriated over \$490,000 from Ruby clients.

6. From 2007 through early 2011, Andrew Franz misappropriated over \$490,000 from approximately 50 Ruby client accounts via fraudulent management fee and redemption requests. The majority of these fraudulently withdrawn funds were initially deposited into Andrew Franz's bank accounts; a smaller portion of the stolen funds was initially deposited into Ruby's bank accounts.

7. Ruby clients' funds were primarily invested in variable annuities or mutual funds. Most Ruby clients signed limited powers of attorney permitting Ruby to request management fees directly from their securities accounts. Andrew Franz and Ruby's office manager were responsible for calculating and requesting Ruby's management fees directly from the securities custodians, which was performed quarterly. These fees were calculated based on the ending balance of the client's account as of the last day of the previous quarter. Most Ruby clients were charged .5% of the quarterly ending balance once per quarter.

8. Andrew Franz's role in the fee request process allowed him to easily misappropriate client funds. In some instances, Andrew Franz provided false client account balances to the Ruby office manager who calculated fees. Sometimes, after the office manager calculated the appropriate management fees and prepared the fee request, Andrew Franz changed the amounts before submitting the request to the annuity or mutual fund company. In other instances, after the office manager prepared and submitted the legitimate management fee request, Andrew Franz submitted additional fraudulent management fee requests days or weeks later.

9. In some instances, Andrew Franz submitted fee requests that instructed that checks be mailed to his home address instead of Ruby's office address. In addition, Andrew Franz was able to easily intercept management fee checks mailed to Ruby because he was the primary person who opened mail at Ruby and because many checks were addressed "Attn: Andrew Franz."

10. Starting in approximately 2006, George Franz had Andrew Franz begin to take over Ruby's operations. George Franz intended to transfer the business to Andrew Franz, since George Franz expected to retire in the next few years.

11. From 2006 through 2011, George Franz spent several months a year in Florida, where he had a residence. During those months, Andrew Franz was present at Ruby's offices and managed Ruby's daily operations. Even when George Franz was in Ohio, he often worked from home, and let Andrew Franz continue to manage Ruby's daily operations.

12. From at least 2006 through 2011, George Franz had sole supervisory responsibility over Andrew Franz as an associated person of Ruby.

From at least January 2007 through early 2011, George Franz became aware of numerous signs of, and instances of, fraud by Andrew Franz.

13. Andrew Franz's repeated misappropriation of client assets was made possible by George Franz's failure to supervise him or take any action to stop him. From January 2007 through early 2011, George Franz became aware of numerous indications of fraud by Andrew Franz.

14. By January 2007, George Franz was aware that in 2006, Andrew Franz had stolen approximately \$12,500 in management fee checks due to Ruby. In response, George Franz instructed Ruby's tax preparer to issue an IRS form 1099 from the company to Andrew Franz for these stolen funds. George Franz did not disclose this information to Ruby clients or take steps to prevent additional fraud by Andrew Franz.

15. In approximately April 2009, George Franz learned that Andrew Franz had stolen hundreds of thousands of dollars from the Marie Franz Trust, a family trust for which George Franz served as trustee. The trust assets had been invested in mutual funds. George Franz learned that Andrew Franz had caused the mutual fund company that held the assets of the trust to issue checks to Ruby's address or to George Franz's home. Andrew Franz then obtained the checks from Ruby's mail or his father's mailbox.

16. In approximately August 2009, George Franz learned that Andrew Franz had stolen numerous other management fee checks issued to Ruby. George Franz also learned that Andrew Franz had diverted a large portion of the stolen funds from management fee checks and the trust into Ruby's bank accounts disguised as revenue, in order to conceal Ruby's dwindling income from his father. George Franz did not disclose this information to Ruby clients.

17. In approximately August 2009, George Franz instructed Ruby's accountant and tax preparer to conduct a review of Andrew Franz's personal bank account to determine how much Andrew Franz had stolen and what he did with the stolen funds. George Franz asked for this review because the stolen funds deposited

into Ruby's accounts, disguised as legitimate revenue, caused Ruby and George Franz to overreport income and thus to overpay income tax.

18. In or before December 2009, George Franz learned that Andrew Franz had stolen a total of about \$800,000 from the Marie Franz Trust from approximately August 2007 through April 2009, depositing these funds into his personal bank account.

19. In or before December 2009, George Franz learned that from approximately November 2007 through June 2009, Andrew Franz had diverted a total of approximately \$170,000 in management fee checks issued from securities custodians to Ruby, depositing them into his personal bank account. George Franz did not disclose this information to Ruby clients.

20. In or before December 2009, Ruby's accountant told George Franz that someone should analyze whether the diverted checks withdrawn from client accounts were properly requested (and thus constituted thefts from Ruby) or fraudulently requested (and thus constituted thefts from Ruby clients). George Franz assured the accountant that he would personally perform this analysis. Some of these checks had been fraudulently requested.

21. In or before December 2009, George Franz learned that from August 2007 through July 2009, Andrew Franz had written checks from his personal bank account to Ruby totaling approximately \$684,000, primarily from the stolen funds. These personal checks were reported as income in Ruby's accounting records, based on misrepresentations by Andrew Franz to Ruby personnel or Ruby's outside accountant.

22. In or before December 2009, George Franz also learned of various other suspicious transactions in Andrew Franz's personal bank account, including a check written to a mutual fund company for "overpayment of fees," various checks to Andrew Franz's company, Wingate, Inc., and checks written directly to Ruby clients.

23. In approximately December 2009, George Franz told Ruby's accountant that he was taking steps to make sure Andrew Franz did not repeat the conduct uncovered by the accountant. In particular, George Franz told the accountant that Andrew Franz was no longer permitted to touch incoming mail at Ruby and that he was no longer permitted to be involved in any deposits into Ruby's bank accounts. Despite these representations, Andrew Franz continued handling incoming mail at Ruby and making deposits into Ruby's bank accounts without consequence. George Franz did not disclose this information to Ruby clients.

24. Meanwhile, starting in approximately July 2009, George Franz became aware of numerous suspicious problems involving management fee checks withdrawn from Ruby client accounts. George Franz did not disclose this information to Ruby clients.

25. For example, in approximately July or August 2009, George Franz learned that Ruby was receiving management fee checks in the mail drawn on Ruby client accounts that had not been requested by Ruby. George Franz learned that some Ruby clients appeared to have been billed twice for management fees for the same quarter, when Ruby had only asked for fees once.

26. In approximately October 2009, George Franz learned that on several occasions, there were management fee checks drawn on Ruby client accounts that had not yet been received by Ruby in the mail, even though the securities custodian reported that the checks had already been cashed. George Franz also learned that Andrew Franz had falsely claimed that the securities custodian had told him the checks had not yet been cashed. George Franz did not disclose this information to Ruby clients.

27. On numerous occasions in 2010, George Franz learned of other irregularities regarding the management fee billing process and checks drawn on Ruby client accounts.

28. For example, in August 2010, George Franz learned that a total of \$4,732.97 in unauthorized management fee checks had been withdrawn from four Ruby client accounts. George Franz also learned that these fee checks had subsequently gone missing. In September 2010, George Franz learned that three of these unauthorized checks had been deposited into Andrew Franz's bank accounts.

29. In October 2010, George Franz wrote checks from Ruby's checking account to these four clients' accounts to reimburse the clients for the \$4,732.97 in total unauthorized fees. On the same day, Andrew Franz wrote a check to Ruby for \$4,732.97. George Franz was aware of this check. Had George Franz not reimbursed these Ruby client accounts, these clients would have been more likely to discover that funds had been stolen. George Franz did not disclose this information to Ruby clients.

30. In January 2011, SEC examination staff conducted an examination of Ruby's offices and operations regarding Andrew Franz's May 2010 forgery of four client signatures on fee requests for the clients' accounts (for fees legitimately owed to Ruby). During this examination, Andrew Franz was present in Ruby's offices and George Franz was at his home in Florida. As part of this examination, George Franz participated in SEC interviews via telephone.

31. During the January 2011 examination, SEC examination staff asked George Franz if he was aware of any potential violations of the securities laws other than Andrew Franz's forgery of the four client signatures in May 2010. George Franz lied, claiming that he was not aware of any other potential violations. In reality, George Franz was aware of those instances noted above.

32. From approximately January 2011 through May 2011, George Franz became aware of numerous additional instances of management fee checks withdrawn from Ruby client accounts going missing, and numerous additional instances of Andrew Franz lying about missing management fee checks. George Franz did not disclose this information to Ruby clients.

33. From approximately January 2011 through March 2011, the Financial Industry Regulatory Authority ("FINRA") made attempts to schedule an On the Record Interview ("OTR") of Andrew Franz in connection with irregularities FINRA had discovered as part of their oversight of Andrew Franz's associated broker-dealer. FINRA scheduled an OTR for Andrew Franz for March 4, 2011, but he did not appear. As a result, Andrew Franz's broker-dealer promptly terminated him. After George Franz learned this, he failed to disclose it to clients or remove Andrew Franz as the listed broker on Ruby's client accounts until many months later.

34. Andrew Franz finally appeared for an OTR with FINRA on April 7, 2011, during which he admitted to numerous instances of fraud and theft from Ruby clients. On May 2, 2011, Andrew Franz signed an Acceptance, Waiver, and Consent ("AWC") with FINRA, in which he acknowledged some of his misconduct and consented to being barred from association with any FINRA broker-dealer. This AWC was accepted by FINRA on May 24, 2011.

35. On April 29, 2011, George Franz informed Andrew Franz that he was terminated from Ruby as of May 31, 2011, after which he would not be allowed entry into Ruby's offices. Between April 29, 2011 and May 31, 2011, Andrew Franz misappropriated another \$15,000 from Ruby clients. George Franz told other Ruby personnel about Andrew Franz's termination. Despite this, Andrew Franz continued to come in to the office and conduct Ruby business until approximately June or July 2011.

Respondents took no meaningful steps to prevent further thefts by Andrew Franz.

36. At all relevant times, George Franz was the Chief Compliance Officer of Ruby. However, George Franz and Ruby failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act.

37. George Franz and Ruby failed to adopt written policies and procedures reasonably designed to prevent violations, even after learning that Andrew Franz had, among other things, stolen Ruby client funds. Before August 2010, Ruby had no compliance procedures at all. Starting in August 2010, Ruby Corporation enacted compliance procedures relating to trading on nonpublic information. These were the only compliance procedures implemented by Ruby prior to Andrew Franz's termination. During the relevant time, Ruby had no procedures reasonably designed to prevent violations of the Advisers Act in connection with the withdrawal of advisory client funds. Moreover, there were no compliance reviews of associated persons of Ruby or of Ruby's compliance procedures until January 2012.

38. Respondents owed a fiduciary duty to all Ruby clients to act in their best interest. Despite everything George Franz learned about Andrew Franz's thefts, including but not limited to the instances described above, he did not disclose these issues to Ruby clients or take any meaningful steps to protect client assets from further thefts until Andrew's admissions to FINRA in April 2011.

39. Until at least approximately April 2011, Respondents did not: (1) remove Andrew Franz and deny him access to Ruby's offices; (2) remove Andrew Franz's access to client accounts; (3) remove Andrew Franz as broker of record on client accounts; (4) inform securities custodians for client accounts to not accept instruction from Andrew Franz on behalf of client accounts; or (5) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act specific to Andrew Franz's means of committing fraud.

40. After Andrew Franz was terminated from his broker dealer and barred from association with any FINRA broker-dealer, George Franz – to ensure that Ruby was paid its management fees – caused Andrew Franz's signature stamp to be used on management fee requests to securities custodians.

**George Franz failed to inform Ruby clients that
Andrew Franz had stolen from their accounts.**

41. On numerous occasions, George Franz became aware that Andrew Franz had caused fraudulent withdrawals out of numerous client accounts and misappropriated the stolen funds. Rather than disclose to clients that Andrew Franz had stolen from their securities accounts, George Franz instead concealed the thefts by secretly replenishing the victim clients' accounts. For example, from October 2010 through April 2012, George Franz wrote 7 checks totaling approximately \$28,000 into the accounts of 22 different Ruby clients. He never disclosed to these clients that their funds had been stolen or that they had been repaid.

George Franz lied to certain Ruby clients about Andrew Franz's thefts from their accounts and Ruby's repayments into their accounts.

42. From approximately May 2011 through approximately July 2013, George Franz told numerous Ruby clients that Andrew Franz had not taken any funds from Ruby clients. He knew that was false.

43. George Franz told certain victims that the withdrawals from their accounts were due to mistake, when he knew they had been taken intentionally by Andrew Franz. For example, Andrew Franz issued quarterly management fee requests eleven times during 2010 for the account of one Ruby client ("Client A"), diverting \$13,552 in fraudulent fee payments into his personal bank account. George Franz learned in March 2011 that these funds were taken fraudulently.

44. In approximately late March 2011, George Franz falsely told Client A that Andrew Franz had caused the \$13,552 to be withdrawn from her account by mistake, and that the client's account was being reimbursed. George Franz knew that Andrew Franz had intentionally caused the withdrawals. On March 30, 2011, George Franz mailed a check for \$13,552 from Ruby's bank account to the securities custodian for Client A's account, instructing that the funds be deposited into the client's account. That same day, Andrew Franz obtained a cashier's check from his bank payable to George Franz for \$13,552, reimbursing him for the funds repaid to Client A's account.

45. From at least 2007 through at least July 2013, George Franz also made numerous other material misrepresentations and omissions to Ruby clients regarding, among other things, Andrew Franz's fraud, George Franz's knowledge of that fraud, and the actions George Franz took after learning of that fraud.

During the SEC's August 2011 examination, George Franz lied to SEC examination staff about what he knew and when he knew it.

46. During the first week of August 2011, SEC examination staff conducted an examination of Ruby in connection with the misconduct uncovered by FINRA and its action against Andrew Franz, including Andrew Franz's thefts from Client A and other Ruby clients in 2010 and early 2011. During this examination, the SEC interviewed George Franz.

47. George Franz told SEC examination staff that he first learned of any potential misconduct by Andrew Franz (other than thefts from the Marie Franz Trust and the four forged client signatures in May 2010) in early 2011. George Franz also told SEC examination staff that once he learned of this misconduct, he immediately fired

Andrew Franz from Ruby. These were lies.

48. During the August 2011 examination, the SEC examination staff interviewed George Franz regarding instances of fraud by Andrew Franz that were known to the SEC staff at the time. During the August 2011 examination, the SEC examination staff asked George Franz if he was aware of any potential violations of the securities laws, other than those discussed during the examination. George Franz answered that he was not. This was not true; he was aware of numerous other indications of fraud by Andrew Franz, including but not limited to the instances noted above.

After the SEC's August 2011 examination and during the early stages of the SEC's subsequent investigation, George Franz destroyed evidence of Andrew Franz's thefts, including Ruby Corporation records.

49. In mid-August 2011, George Franz and his attorney met with SEC enforcement and examination staff to discuss the SEC's investigation, which at that time had only involved instances of fraud by Andrew Franz in 2010 and 2011. During this meeting, the SEC staff told George Franz that he had a fiduciary responsibility to Ruby clients and an obligation to investigate Andrew Franz's thefts to determine the full extent of his fraud. The SEC staff told George Franz that at a minimum he should investigate the prior five years of transactions, such as via a forensic accounting, to ensure that there were not additional undiscovered thefts by Andrew Franz. The SEC staff also told George Franz that the SEC would continue to investigate Andrew Franz's fraud, including potential fraud prior to 2010.

50. At all relevant times, Ruby was obligated under Section 204(a) of the Advisers Act and Rule 204-2 thereunder to maintain and preserve all books and records relating to Ruby's operations, including revenue, for a total of five years after the end of the year to which the record relates. As of November 2011, Ruby was obligated to maintain and preserve all such books and records for the time frame January 1, 2006 through November 2011.

51. In November 2011, George Franz knowingly caused numerous Ruby documents to be destroyed. Among other records, George Franz caused to be destroyed records related to Ruby's quarterly management fee requests to mutual fund and annuity companies. These destroyed records related to transactions from at least January 1, 2006 through December 31, 2009. These destroyed records included numerous documents reflecting misconduct by Andrew Franz.

52. George Franz was aware that Ruby's records for the time period prior to 2010 contained evidence of additional fraud by Andrew Franz, as well as evidence of George Franz's knowledge of Andrew Franz's fraud prior to 2010. On various occasions in 2008 and 2009, Ruby's former office manager informed George Franz of these instances of potential fraud by Andrew Franz as she became aware of them, and showed George Franz documents reflecting such fraud. Ruby's former office manager maintained additional copies of some of the evidence of Andrew Franz's potential fraud prior to 2010 that had also been located in Ruby's records prior to their destruction.

George Franz commissioned a sham accounting engagement that he used to mislead numerous Ruby clients.

53. From September 2011 through August 2012, Respondents engaged an accounting firm to perform an agreed-upon procedures engagement regarding management fees charged by Ruby ("engagement"), supposedly in an effort to identify all instances of misappropriation by Andrew Franz. This engagement was commissioned in response to the SEC's discussions with George Franz in mid-August 2011 described in paragraph 49 above.

54. This engagement consisted of performing certain specified procedures, and included no attestation by the accounting firm as to whether Ruby clients were defrauded or overbilled. In addition, as George Franz was aware, the particular procedures constituting this engagement could not be expected to uncover the types of transactions by which Andrew Franz typically misappropriated funds from Ruby clients. Moreover, the engagement only involved the time period of January 1, 2010 through June 30, 2011. Finally, George Franz substantially misled the accounting firm and withheld information material to their analysis in order to influence the results of the analysis. For example, George Franz provided the accounting firm with a fraudulently altered check and lied to the accounting firm about the check's purpose. As a result, the vast majority of Andrew Franz's fraud was not identified in the engagement.

55. Despite knowledge of the above facts and the sham nature of the exercise, George Franz told numerous Ruby clients that an audit had been performed of all Ruby client accounts. George Franz misled numerous Ruby clients (including victims of Andrew Franz's fraud), causing them to believe that if they had not been identified as a victim of the audit, they could take comfort that they had not been a victim.

**During the Division's investigation, Respondents
provided fabricated documents to the Division.**

56. During a September 11, 2012 investigative testimony, George Franz testified that he had informed all known victims of Andrew Franz's fraud that they had been victimized, either verbally or in writing.

57. In November 2012, in response to SEC subpoenas, Respondents produced to the SEC letters from George Franz to four Ruby clients who had funds stolen by Andrew Franz and whose accounts were later reimbursed by Ruby. These four letters stated that Andrew Franz had stolen the clients' funds and that the amounts were being repaid by Ruby. Three of these letters referenced specific conversations between George Franz and the client regarding Andrew Franz's misconduct.

58. None of these four clients ever received these letters, and the conversations referenced in three of the letters never took place.

59. In addition to these four letters, Respondents produced to the SEC a letter to another client ("Client B") that the client never received. In an April 14, 2011 letter, Client B complained to George Franz that in March 2010 her account had been transferred out of an existing variable annuity without her consent, causing an approximately \$6,000 early surrender charge to the account. In her complaint letter, Client B told George Franz that throughout 2010, Andrew Franz had repeatedly lied to her about the surrender charge, falsely claiming it was a mistake that would be repaid.

60. In her complaint letter to George Franz, Client B threatened to report the matter to FINRA and the SEC if George Franz did not reimburse her for the surrender charge. In a response letter on April 29, 2011, George Franz claimed that he had previously informed Client B of the surrender charge in a March 2010 meeting, that he had previously sent Client B a letter disclosing the charge in March 2010, and that the client had agreed to the account transfer in that March 2010 meeting despite being aware of the surrender charge. These were lies.

61. In reality, Andrew Franz had forged Client B's signature on the account transfer form. Client B never received the March 2010 disclosure letter, nor did she participate in any March 2010 meeting. George Franz simply fabricated a story in which Client B – with full knowledge of the surrender charge – had consented to the account transfer, and then fabricated a letter to support that story. George Franz took these steps to protect Andrew Franz and Ruby from a potential FINRA or SEC investigation as a result of Client B's complaint.

62. Client B's April 14, 2011 complaint letter, George Franz's April 29, 2011 response letter, and the fabricated March 2010 letter were produced to the SEC pursuant to subpoena as part of Client B's client file maintained at Ruby.

63. These five fabricated letters were not the only times that George Franz "papered the file" with unsent letters to clients in order to defend against claims that he lied or withheld material facts. In 2004 and 2005, George Franz told three potential clients that Ruby only received a fee if the clients' securities account managed by Ruby gained in value, and that Ruby's fee would be a percentage of that gain. This was false; Ruby was paid 2% of the clients' portfolio value each year regardless of whether the account gained or lost value. After the clients complained about these undisclosed fees a year later, George Franz claimed that he previously disclosed these fees, and specifically cited two letters he supposedly wrote to the clients. The clients never received these letters.

George Franz lied under oath during the investigation.

64. During investigative testimony before the SEC enforcement staff, George Franz made numerous statements that were false.

65. For example, during investigative testimony on September 11, 2012, George Franz testified that he had disclosed to all known victims of Andrew Franz's fraud the fact that they had been victims of misappropriation from their accounts. This testimony was false.

66. Further, during investigative testimony on March 6, 2013, George Franz testified that he had mailed the letters referenced in paragraphs 57 through 61 above, and that he had made the disclosures to clients referenced in those letters. This testimony was false.

Respondents filed a false SEC Form ADV Part 2A.

67. On or around April 16, 2012, Ruby filed a Form ADV Part 2A (dated November 30, 2011), disclosing that Andrew Franz was a former associated person of Ruby, but was removed from the firm because he had consented to a FINRA bar based on allegations of misappropriation, and stating, in Item 9:

[Andrew] Franz: (1) misappropriated funds belonging to Ruby Corporation and its clients in violation of NASD Conduct Rule 2110 and (2) forged an investor's signature and misappropriated his funds in violation of FINRA Rule 2010. This conduct was unknown to George B. Franz III and Ruby Corporation.

68. This Form ADV Part 2A was filed with the Commission and provided to Ruby clients.

69. The claim that "this conduct was unknown to George B. Franz III and Ruby Corporation" was false at the time this Form ADV Part 2A was filed. At the time this form was filed, George Franz knew that this claim was false.

VIOLATIONS

70. As a result of the conduct described above, Andrew Franz violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with any purchase or sale of security.

71. As a result of the conduct described above, Andrew Franz violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

72. As a result of the conduct described above, George Franz and Ruby Corporation failed reasonably to supervise Andrew Franz.

73. As a result of the conduct described above, Ruby Corporation willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

74. As a result of the conduct described above, George Franz and Ruby Corporation willfully violated Sections 206(1) and 206(2) of the Advisers Act.

75. As a result of the conduct described above, George Franz willfully aided and abetted and caused Andrew Franz's and Ruby Corporation's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act.

76. As a result of the conduct described above, Ruby Corporation willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which among other things require that investment advisers registered with the Commission adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act.

77. As a result of the conduct described above, George Franz willfully aided and abetted and caused Ruby Corporation's violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

78. As a result of the conduct described above, Ruby Corporation willfully violated Section 204(a) of the Advisers Act and Rule 204-2 thereunder, which require that investment advisers registered with the Commission maintain and preserve certain books and records.

79. As a result of the conduct described above, George Franz willfully aided and abetted and caused Ruby Corporation's violation of Section 204(a) of the Advisers Act and Rule 204-2 thereunder.

80. As a result of the conduct described above, Ruby Corporation willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

81. As a result of the conduct described above, George Franz willfully violated, and aided and abetted and caused Ruby Corporation's violation of, Section 207 of the Advisers Act.

UNDERTAKING

82. Respondent Ruby Corporation undertakes, within 14 calendar days of the entry of the Order, to withdraw its request dated December 14, 2012, for a hearing in response to the Commission's Notice of Intention to Cancel Registrations of Certain Investment Advisers Pursuant to Section 203(h) of the Investment Advisers Act of 1940, Release No. IA-3490 (Oct. 19, 2012).

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Joint Offer.

Accordingly, pursuant to Sections 203(e), (f), and (k) of the Advisers Act, Section 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents George Franz and Ruby Corporation shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 204, 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2 and 206(4)-7 promulgated thereunder.

B. Respondent George Franz be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

Any reapplication for association by Respondent Franz will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Franz, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

C. The registration of Respondent Ruby Corporation as an investment adviser be, and hereby is revoked.

D. Respondent Ruby Corporation shall comply with the undertaking set forth in Paragraph 82 of this Order.

E. Respondents George Franz and Ruby Corporation shall jointly and severally, within 14 calendar days of the entry of this Order, pay disgorgement of \$394,452² and prejudgment interest of \$30,548 (together "the Distribution Fund") and civil penalties of \$675,000, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;³

² The amount of disgorgement ordered reflects prior payments by the Respondents to victims totaling \$92,938.

³ The minimum threshold for transmission of payment electronically is \$1,000,000. For amounts below this threshold, Respondents must make payments pursuant to option (2) or (3) above.

- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying George Franz and Ruby Corporation as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert J. Burson, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL, 60604.

F. After receipt of Respondents' payment of disgorgement and prejudgment interest, the Commission shall within 90 days, make payments to Clients 1 through 43 as set forth in Exhibit 1 hereto. The amount of each of these payments represents the dollar amount of each client's net loss plus reasonable interest as calculated by the Commission staff. After the Commission makes these payments, any remaining funds consisting of Respondent's disgorgement, prejudgment interest, and penalties paid, shall remain on deposit with the Commission pending further approval by the Commission of (1) a plan to distribute some or all of the remaining funds pursuant to the Commission's Rules on Fair Funds and Disgorgement Plans or (2) the transfer of remaining funds to the U.S. Treasury. Commission staff will seek the appointment a tax administrator for the above payments to clients (as well as any additional payments that may be made in the event a plan of distribution is approved) as they constitute a qualified settlement fund ("QSF") under section 468B(g) of the Internal Revenue Code (IRC), 26 U.S.C. § 468B(g), and related regulations, 26 C.F.R. §§ 1.468B-1 through 1.468B-5. Taxes, if any, and related administrative expenses will be paid from the remaining funds. Regardless of whether any Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty

Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against a Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.


Lynn M. Powalski
Deputy Secretary

Exhibit 1

In the Matter of George Franz and Ruby Corporation
Distributions to Victims

	\$ 358,029	\$ 6,202	\$ 364,231
	Net Loss	Interest	Total
Client 1	\$ 1,857	\$ 10	\$ 1,867
Client 2	\$ 2,182	\$ 7	\$ 2,189
Client 3	\$ 1,607	\$ 7	\$ 1,614
Client 4	\$ 1,116	\$ 6	\$ 1,122
Client 5	\$ 630	\$ 3	\$ 633
Client 6	\$ 1,399	\$ 7	\$ 1,406
Client 7	\$ 177	\$ 33	\$ 210
Client 8	\$ 9,611	\$ 83	\$ 9,695
Client 9	\$ 125,110	\$ 527	\$ 125,637
Client 10	\$ 1,164	\$ 40	\$ 1,204
Client 11	\$ 385	\$ 2	\$ 387
Client 12	\$ 12,139	\$ 108	\$ 12,247
Client 13	\$ 10,660	\$ 101	\$ 10,761
Client 14	\$ 1,189	\$ 41	\$ 1,229
Client 15	\$ 66,362	\$ 1,202	\$ 67,564
Client 16	\$ 1,426	\$ 49	\$ 1,474
Client 17	\$ 3,095	\$ 38	\$ 3,134
Client 18	\$ 1,198	\$ 6	\$ 1,204
Client 19	\$ 271	\$ 1	\$ 272
Client 20	\$ 1,435	\$ 8	\$ 1,442
Client 21	\$ 12,498	\$ 58	\$ 12,556
Client 22	\$ 8,179	\$ 1,401	\$ 9,579
Client 23	\$ 421	\$ 3	\$ 424
Client 24	\$ 3,544	\$ 218	\$ 3,763
Client 25	\$ 10,708	\$ 1,653	\$ 12,361
Client 26	\$ 3,522	\$ 17	\$ 3,539
Client 27	\$ 1,764	\$ 9	\$ 1,773
Client 28	\$ 593	\$ 2	\$ 595
Client 29	\$ 1,140	\$ 5	\$ 1,145
Client 30	\$ 8,016	\$ 61	\$ 8,076
Client 31	\$ 66	\$ 0	\$ 66
Client 32	\$ 2,340	\$ 11	\$ 2,350
Client 33	\$ 1,889	\$ 10	\$ 1,899
Client 34	\$ 154	\$ 1	\$ 155
Client 35	\$ -	\$ 13	\$ 13
Client 36	\$ 7,878	\$ 39	\$ 7,918
Client 37	\$ 35,556	\$ 332	\$ 35,888
Client 38	\$ 403	\$ 1	\$ 405
Client 39	\$ 28	\$ 1	\$ 29
Client 40	\$ 3,580	\$ 19	\$ 3,599
Client 41	\$ 6,294	\$ 33	\$ 6,327
Client 42	\$ 5,826	\$ 25	\$ 5,851
Client 43	\$ 618	\$ 9	\$ 627

