

## 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:

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

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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, Hori 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.

Hori is currently subject to probation under the California Board of Accountancy that is scheduled to end in April, 2008. Failure to abide by the terms of his probation could result in the revocation of Hori's CPA license pending notice and an opportunity to be heard by the California Board of Accountancy. Hori 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 the reinstatement of his privilege to appear or 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."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Hori, it appears that he has complied with the terms of the October 20, 2004 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 Hori, 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 Hori, 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,

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<sup>2</sup> 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 David A. Hori, CPA is hereby reinstated to appear and practice before the Commission as an accountant.

By the Commission.

Nancy M. Morris  
Secretary

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

**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

[Docket No. 06-17]

**Office of Thrift Supervision**

[Docket No. 2006-55]

**FEDERAL RESERVE SYSTEM**

[Docket No. OP-1254]

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-55043; File No. S7-08-06]

**Interagency Statement on Sound Practices Concerning**

**Elevated Risk Complex Structured Finance Activities**

**AGENCIES:** Office of the Comptroller of the Currency, Treasury ("OCC"); Office of Thrift Supervision, Treasury ("OTS"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); and Securities and Exchange Commission ("SEC") (collectively, the "Agencies").

**ACTION:** Notice of final interagency statement.

**SUMMARY:** The Agencies are adopting an Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities ("Final Statement").

The Final Statement pertains to national banks, state banks, bank holding companies (other than foreign banks), federal and state savings associations, savings and loan holding companies, U.S. branches and agencies of foreign banks, and SEC-registered broker-dealers and investment advisers (collectively, "financial institutions" or

“institutions”) engaged in complex structured finance transactions (“CSFTs”). In May 2004, the Agencies issued and requested comment on a proposed interagency statement (“Initial Proposed Statement”). After reviewing the comments received on the Initial Proposed Statement, the Agencies in May 2006 issued and requested comment on a revised proposed interagency statement (“Revised Proposed Statement”). The modifications to the Revised Proposed Statement, among other things, made the statement more principles-based and focused on the identification, review and approval process for those CSFTs that may pose heightened levels of legal or reputational risk to the relevant institution (referred to as “elevated risk CSFTs”). After carefully reviewing the comments on the Revised Proposed Statement, the Agencies have adopted the Final Statement with minor modifications designed to clarify, but not alter, the principles set forth in the Revised Proposed Statement. The Final Statement describes some of the internal controls and risk management procedures that may help financial institutions identify, manage, and address the heightened reputational and legal risks that may arise from elevated risk CSFTs. As discussed further below, the Final Statement will not affect or apply to the vast majority of financial institutions, including most small institutions, nor does it create any private rights of action.

**EFFECTIVE DATE:** The Final Statement is effective upon [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:**

OCC: Kathryn E. Dick, Deputy Comptroller, Credit and Market Risk, (202) 874-4660; Grace E. Dailey, Deputy Comptroller, Large Bank Supervision, (202) 874-4610; or Ellen

Broadman, Director, Securities and Corporate Practices Division, (202) 874-5210, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC 20219.

OTS: Fred J. Phillips-Patrick, Director, Credit Policy, (202) 906-7295, and Deborah S. Merkle, Project Manager, Credit Policy, (202) 906-5688, Examinations and Supervision Policy; or David A. Permut, Senior Attorney, Business Transactions Division, (202) 906-7505, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

Board: Sabeth I. Siddique, Assistant Director; (202) 452-3861, or Virginia Gibbs, Senior Supervisory Financial Analyst, (202) 452-2521, Division of Banking Supervision and Regulation; or Kieran J. Fallon, Assistant General Counsel, (202) 452-5270, or Anne B. Zorc, Senior Attorney, (202) 452-3876, Legal Division, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, NW, Washington, DC 20551. Users of Telecommunication Device for Deaf (TTD) only, call (202) 263-4869.

FDIC: Jason C. Cave, Associate Director, (202) 898-3548; Division of Supervision and Consumer Protection; or Mark G. Flanigan, Counsel, Supervision and Legislation Branch, Legal Division, (202) 898-7426, Federal Deposit Insurance Corporation, 550 17<sup>th</sup> Street, NW, Washington, DC 20429.

SEC: Mary Ann Gadziala, Associate Director, Office of Compliance Inspections and Examinations, (202) 551-6207; Catherine McGuire, Chief Counsel, Linda Stamp Sundberg, Senior Special Counsel (Banking and Derivatives), or Randall W. Roy, Branch Chief, Division of Market Regulation, (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

Financial markets have grown rapidly over the past decade, and innovations in financial instruments have facilitated the structuring of cash flows and allocation of risk among creditors, borrowers, and investors in more efficient ways. Financial derivatives for market and credit risk, asset-backed securities with customized cash flow features, specialized financial conduits that manage pools of assets, and other types of structured finance transactions serve important purposes, such as diversifying risk, allocating cash flows and reducing cost of capital. As a result, structured finance transactions, including the more complex variations of these transactions, now are an essential part of U.S. and international capital markets.

When a financial institution participates in a CSFT, it bears the usual market, credit, and operational risks associated with the transaction. In some circumstances, a financial institution also may face heightened legal or reputational risks due to its involvement in a CSFT. For example, a financial institution involved in a CSFT may face heightened legal or reputational risk if the customer's regulatory, tax or accounting treatment for the CSFT, or disclosures concerning the CSFT in its public filings or financial statements, do not comply with applicable laws, regulations or accounting principles.<sup>1</sup>

In some cases, certain CSFTs appear to have been used in illegal schemes that misrepresented the financial condition of public companies to investors and regulatory authorities. After conducting investigations, the OCC, Federal Reserve System and SEC

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<sup>1</sup> For a memorandum on the potential liability of a financial institution for securities laws violations arising from participation in a CSFT, see Letter from Annette L. Nazareth, Director, Division of Market Regulation, Securities and Exchange Commission, to Richard Spillenkothen and Douglas W. Roeder, dated December 4, 2003 (available at <http://www.federalreserve.gov/boarddocs/srletters/2004/> and <http://www.occ.treas.gov>).

took strong and coordinated civil and administrative enforcement actions against certain financial institutions that engaged in CSFTs that appeared to have been designed or used to shield their customers' true financial health from the public. These actions involved the assessment of significant financial penalties on the institutions and required the institutions to take several measures to strengthen their risk management procedures for CSFTs.<sup>2</sup> The complex structured finance relationships involving these financial institutions also sparked an investigation by the Permanent Subcommittee on Governmental Affairs of the United States Senate,<sup>3</sup> as well as numerous lawsuits by private litigants.

The OCC, Federal Reserve System and SEC also conducted special reviews of several large financial institutions engaged in CSFTs, and the Agencies have focused attention on the CSFT activities of financial institutions in the normal course of the supervisory process. These reviews and activities indicate that many of the large financial institutions engaged in CSFTs have taken meaningful steps in recent years to improve their control infrastructure relating to CSFTs.

## **II. Initial and Revised Proposed Statements**

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<sup>2</sup> See, e.g., In the Matter of Citigroup, Inc., Securities Exchange Act Release No. 48230 (July 28, 2003), Written Agreement by and between Citibank, N.A. and the Office of the Comptroller of the Currency, No. 2003-77 (July 28, 2003) (pertaining to transactions entered into by Citibank, N.A. with Enron Corp.) and Written Agreement by and between Citigroup, Inc. and the Federal Reserve Bank of New York, dated July 28, 2003 (pertaining to transactions involving Citigroup Inc. and its subsidiaries and Enron Corp. and Dynegy Inc.); SEC v. J.P. Morgan Chase, SEC Litigation Release No. 18252 (July 28, 2003) and Written Agreement by and among J.P. Morgan Chase & Co., the Federal Reserve Bank of New York, and the New York State Banking Department, dated July 28, 2003 (pertaining to transactions involving J.P. Morgan Chase & Co. and its subsidiaries and Enron Corp.).

<sup>3</sup> See Fishtail, Bacchus, Sundance, and Slapshot: Four Enron Transactions Funded and Facilitated by U.S. Financial Institutions, Report Prepared by the Permanent Subcomm. on Investigations, Comm. on Governmental Affairs, United States Senate, S. Rpt. 107-82 (2003).

To assist financial institutions in identifying, managing, and addressing the risks that may be associated with CSFTs, the Agencies developed and requested public comment on the Initial Proposed Statement.<sup>4</sup> The Initial Proposed Statement described the types of policies and procedures that a financial institution engaged in CSFTs should have in place to allow the institution to identify, document, evaluate, and control the full range of credit, market, operational, legal, and reputational risks that may arise from CSFTs. The agencies collectively received comments from more than 40 commenters on the Initial Proposed Statement. Although commenters generally supported the Agencies' efforts to describe the types of risk management procedures and internal controls that may help institutions manage the risks associated with CSFTs, virtually all of the commenters recommended changes to the Initial Proposed Statement.

After carefully reviewing the comments on the Initial Proposed Statement, the Agencies issued and requested comment on a Revised Proposed Statement.<sup>5</sup> The Revised Proposed Statement was modified in numerous respects to clarify the purpose, scope and effect of the statement; make the statement more risk-focused and principles based; and focus the statement on those CSFTs that may pose elevated levels of legal or reputational risk to the relevant institution.<sup>6</sup>

### **III. Overview of Comments on the Revised Proposed Statement**

The Agencies collectively received written comments from 19 commenters on the Revised Proposed Statement, although many commenters submitted identical comments

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<sup>4</sup> See 69 FR 28980, May 19, 2004.

<sup>5</sup> See 71 FR 28326, May 16, 2006.

<sup>6</sup> A more detailed summary of the comments on the Initial Proposed Statement, as well as the changes made in response to those comments, is contained in the Federal Register notice accompanying the Revised Proposed Statement (71 FR 28326, 28328-29 (May 16, 2006)).

to multiple Agencies. Commenters included banking organizations, financial services trade associations, and individuals. Commenters generally expressed strong support for the Revised Proposed Statement, including its principles-based structure and focus on elevated risk CSFTs. Many commenters also asserted that the Revised Proposed Statement provides a financial institution appropriate flexibility to develop internal controls and risk management procedures that are tailored to the institution's own business activities and organizational structure.

Several commenters requested that the Agencies clarify or revise the Revised Proposed Statement in certain respects. For example, some commenters asked the Agencies to further streamline the provisions in the statement pertaining to documentation of elevated risk CSFTs, or clarify how the U.S. branches or agencies of foreign banks might implement risk management systems, policies or controls consistent with the statement's principles. In addition, some commenters asked the Agencies to set forth or clarify the legal standards governing the potential liability of financial institutions for CSFTs or provide "safe harbors" from such potential liability. One group of commenters also argued that the Revised Proposed Statement should not be implemented because it allegedly would encourage or condone illegal conduct by financial institutions. The comments received on the Revised Proposed Statement are further discussed below.

#### **IV. Overview of Final Statement**

After carefully reviewing the comments on the Revised Proposed Statement, the Agencies have made minor modifications to the Revised Proposed Statement in response to comments and to clarify the principles, scope, and intent of the Final Statement. The Final Statement has been adopted as supervisory guidance by the Board, OCC, FDIC and

OTS and as a policy statement by the SEC. The Agencies will use the Final Statement going forward in reviewing the internal controls and risk management policies, procedures and systems of financial institutions engaged in CSFTs as part of the Agencies' ongoing supervisory process.

The Agencies continue to believe that it is important for a financial institution engaged in CSFTs to have policies and procedures that are designed to allow the institution to effectively manage and address the full range of risks associated with its CSFT activities, including the elevated legal or reputational risks that may arise in connection with certain CSFTs. For this reason, the Final Statement describes the types of risk management principles that the Agencies believe may help a financial institution to identify elevated risk CSFTs and to evaluate, manage, and address these risks within the institution's internal control framework.<sup>7</sup> These policies and procedures should, among other things, be designed to allow the institution to identify elevated risk CSFTs during its transaction and new product approval processes, and should provide for elevated risk CSFTs to be reviewed by appropriate levels of control and management personnel at the institution, including personnel from control areas that are independent of the business line(s) involved in the transaction.

The Final Statement – like the Revised Proposed Statement – applies to financial institutions that are engaged in CSFT activities and focuses on those CSFTs that may create heightened levels of legal or reputational risks for a participating financial institution. Because CSFTs typically are conducted by a limited number of large

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<sup>7</sup> As noted in the Final Statement, financial institutions are encouraged to refer to other supervisory guidance and materials prepared by the Agencies for further information concerning market, credit and operational risk, as well as for further information on legal and reputational risk, internal audit and internal controls.

financial institutions, the Final Statement will not affect or apply to the vast majority of financial institutions, including most small institutions.

As the Final Statement recognizes, structured finance transactions encompass a broad array of products with varying levels of complexity. Most structured finance transactions, such as standard public mortgage-backed securities and hedging-type transactions involving "plain vanilla" derivatives or collateralized debt obligations, are familiar to participants in the financial markets, have well-established track records, and typically would not be considered CSFTs for purposes of the Final Statement. Some commenters requested that the Agencies provide a more extensive list of structured finance transactions that typically would not be considered CSFTs. The Agencies note that the types of non-complex transactions listed in the Final Statement are only examples of the types of transactions that typically would not be considered CSFTs and that any list of examples would not, and could not, be all inclusive given the changing nature of the structured finance market. Consistent with the principles-based approach of the Final Statement, the Agencies believe the statement appropriately highlights the hallmarks of a non-complex transaction – *i.e.*, a well established track record and familiarity to participants in the financial markets – that may guide institutions and examiners in considering whether a particular type of transaction should be considered a CSFT now or in the future.

**A. Identification, Due Diligence, and Approval Processes for Elevated Risk CSFTs**

As noted above, a financial institution should establish and maintain policies, procedures and systems that are designed to identify elevated risk CSFTs as part of the institution's transaction or new product approval processes, and to ensure that transactions or new products identified as elevated risk CSFTs are subject to heightened review.<sup>8</sup> In general, a financial institution should conduct the level and amount of due diligence for an elevated risk CSFT that is commensurate with the level of risks identified. A financial institution's policies and procedures should provide that CSFTs identified as potentially having elevated legal or reputational risk are reviewed and approved by appropriate levels of management. The Agencies continue to believe that the designated approval process for elevated risk CSFTs should include the institution's representatives from the relevant business line(s) and/or client relationship management, as well as from appropriate control areas that are independent of the business line(s) involved in the transaction. An institution's policies should provide that new complex structured finance products receive the approval of all relevant control areas that are independent of the profit center before the product is offered to customers.<sup>9</sup>

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<sup>8</sup> In response to comments, the Agencies have modified the Final Statement to clarify that a U.S. branch or agency of a foreign bank is not necessarily expected to establish or adopt separate U.S.-based risk management structures or policies for its CSFT activities. In addition, the Agencies believe the Final Statement provides U.S. branches and agencies of foreign banks sufficient flexibility to develop controls, risk management and reporting structures, and lines of authority that are consistent with the internal management structure of U.S. branches and agencies. However, the risk management structure and policies used by a U.S. branch or agency, whether adopted or implemented on a group-wide or stand-alone basis, should be effective in allowing the branch or agency to manage the risks associated with its CSFT activities.

<sup>9</sup> One commenter sought clarification regarding when during the new product approval process a new complex structured finance product should receive the approval of relevant control areas. The Agencies note that the Final Statement is not intended to prevent institutions from engaging in initial or preliminary discussions or negotiations with potential customers about a new complex structured finance product.

The Final Statement – like the Revised Proposed Statement – provides examples of transactions that may warrant additional scrutiny by an institution. These examples include, among other things, transactions that appear to the institution to:

- Lack economic substance or business purpose;
- Be designed or used primarily for questionable accounting, regulatory, or tax objectives, particularly when the transactions are executed at year-end or at the end of a reporting period for the customer; or
- Raise concerns that the client will report or disclose the transaction in its public filings or financial statements in a manner that is materially misleading or inconsistent with the substance of the transaction or applicable regulatory or accounting requirements.

A few commenters contended that the examples of elevated risk CSFTs contained in the Revised Proposed Statement have characteristics that are signals, if not conclusive proof, of fraudulent activity, and recommended that the Agencies inform financial institutions that transactions or products with any of these characteristics should be considered presumptively prohibited. The commenters also argued that the statement encourages or condones illegal conduct by financial institutions. The Agencies believe that CSFTs that initially appear to an institution, during the ordinary course of its new product or transaction approval process, to have one or more of the characteristics identified in the Final Statement should generally be identified as an elevated risk CSFT, and the institution should conduct due diligence for the transaction that is commensurate

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However, an institution should obtain the necessary approvals for a new complex structured finance product from appropriate control areas before the institution enters into, or becomes obligated to enter into, a transaction with the customer.

with the level of identified, potential risks. The Agencies, however, do not believe it is appropriate to provide that all transactions initially identified as potentially creating elevated legal or reputational risks for an institution should be considered presumptively prohibited. For example, an institution, after conducting additional due diligence for a transaction initially identified as an elevated risk CSFT, may determine that the transaction does not, in fact, have the characteristics that initially triggered the review. Alternatively, the institution may take steps to address the legal or reputational risks that initially triggered the review. In this regard, the Final Statement expressly provides that, if after evaluating an elevated risk CSFT, a financial institution determines that its participation in the transaction would create significant legal or reputational risks for the institution, the financial institution should take appropriate steps to manage and address these risks. Such steps may include modifying the transaction or conditioning the institution's participation in the transaction upon the receipt of representations or assurances from the customer that reasonably address the heightened risks presented by the transaction.

Importantly, the Final Statement continues to provide that a financial institution should decline to participate in an elevated risk CSFT if, after conducting appropriate due diligence and taking appropriate steps to address the risks from the transaction, the institution determines that the transaction presents unacceptable risks to the institution or would result in a violation of applicable laws, regulations or accounting principles.<sup>10</sup> The

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<sup>10</sup> Some commenters asked the Agencies to clarify that the Final Statement does not necessarily prevent a financial institution from proceeding with a CSFT simply because there may be some ambiguity in how the transaction might be viewed under the law or applicable accounting principles. The Agencies recognize that in certain circumstances ambiguities may exist as to how the law or accounting principles apply to a CSFT, particularly in light of the inherent complexity and rapidly evolving nature of CSFTs. Nevertheless, as discussed in the Final Statement, a financial institution should maintain strong and effective processes

Final Statement also expressly notes that financial institutions must conduct their activities in accordance with applicable statutes and regulations. The Agencies believe the Final Statement should assist financial institutions engaged in CSFTs in managing the risks associated with these activities and complying with the law, and does not, as some commenters alleged, encourage or condone illegal conduct.

Some commenters also requested that the Agencies enunciate, clarify or modify the legal standards governing the potential liability of a financial institution for participating in a CSFT that is used for fraudulent or illegal purposes. For example, some commenters asked the Agencies to declare that institutions do not have a duty to ensure the accuracy of a client's public filings or accounting. Other commenters asked that the Agencies state that an institution will not be held liable or responsible for a CSFT if the institution has a reasonable degree of confidence that the customer will report or account for the transactions properly. Other commenters expressed concern that the Revised Proposed Statement, or the comments submitted on that document, attempted to alter the current legal standards under which a financial institution may be held liable for fraudulent activity or criminally responsible under the Federal securities law or other laws.

As events in recent years have highlighted, institutions may in certain circumstances bear significant legal or reputational risk from participating in a CSFT. In light of these risks, the Final Statement describes the types of risk management systems and internal controls that may help a financial institution engaged in CSFTs to identify those CSFTs that may pose heightened legal or reputational risk to the institution, and to

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and controls designed to determine whether any such ambiguities may create significant legal or reputational risks for the institution and to manage and address those risks as appropriate.

evaluate, manage, and address those risks. Because the Final Statement represents guidance on the part of the Banking Agencies and a policy statement on the part of the SEC, it does not, by itself, establish any legally enforceable requirements or obligations. Moreover, as the Final Statement expressly provides, it does not create any private rights of action, nor does it alter or expand the legal duties and obligations that a financial institution may have to a customer, its shareholders or other parties under applicable law. Accordingly, the Agencies do not believe it is appropriate or possible to address in the Final Statement these legal concerns expressed by commenters.

**B. Documentation**

The Final Statement states that a financial institution should create and collect sufficient documentation to, among other things, verify that the institution's policies and procedures related to elevated risk CSFTs are being followed and allow the internal audit function to monitor compliance with those policies and procedures. The Final Statement also provides that, when an institution's policies and procedures require an elevated risk CSFT to be submitted for approval to senior management, the institution should maintain the transaction-related documentation provided to senior management as well as other documentation that reflect management's approval (or disapproval) of the transaction, any conditions imposed by senior management, and the reasons for such action.

Several commenters strongly suggested that the Agencies should eliminate or modify the portions of the statement that provide for a financial institution to maintain certain documentation related to elevated risk CSFTs that are submitted to the institution's senior management for approval (or denial). For example, some commenters argued that institutions should not be required to maintain any documentation for

declined transactions. Other commenters expressed concern that this provision was inconsistent with the current practice of financial institutions, would require financial institutions to create new and potentially extensive documentation to memorialize all aspects of the institution's analytical and decision-making process with respect to an elevated risk CSFT, or would require institutions to create or maintain extensive documentation even for transactions that are approved or rejected by junior staff.

As an initial matter, the Agencies note that the Final Statement's provisions regarding documentation for elevated risk CSFTs submitted to senior management for approval (or disapproval) do not apply to transactions that may be reviewed and acted on by more junior personnel in accordance with the institution's policies and procedures. Rather, these provisions apply only to those elevated risk CSFTs that are identified by the institution as potentially involving the greatest degree of risk to the institution and, for this reason, are required to be reviewed by the institution's senior management. The Agencies believe that it is important for institutions to maintain documentation for this category of elevated risk CSFTs, whether approved or declined, that reflects the factors considered by senior management in taking such action. The Agencies believe this type of documentation may be of significant benefit to the institution and to the Agencies in reviewing the effectiveness of the institution's CSFT-related policies, procedures, and internal controls. However, to help address the commenter's concern about potential burden, the Agencies have modified the Final Statement to recognize that the minutes of an institution's reviewing senior management committee may have the information described and to clarify that the documentation for a transaction should reflect the factors

considered by senior management in taking action, but does not have to detail every aspect of the institution's legal or business analysis of the transaction.<sup>11</sup>

**C. General Risk Management Principles for Elevated Risk CSFTs**

The Final Statement – like the Revised Proposed Statement – also describes some of the other key risk management policies and internal controls that financial institutions should have in place for elevated risk CSFTs. For example, the Final Statement provides that the board of directors and senior management of an institution should establish a “tone at the top” through both actions and formalized policies that sends a strong message throughout the financial institution about the importance of compliance with the law and overall good business ethics. The Final Statement also describes the types of training, reporting mechanisms, and audit procedures that institutions should have in place with respect to elevated risk CSFTs. The Final Statement also provides that a financial institution should conduct periodic independent reviews of its CSFT activities to verify and monitor that its policies and controls relating to elevated risk CSFTs are being implemented effectively and that elevated risk CSFTs are accurately identified and receive proper approvals.

In response to comments, the Agencies have modified the Final Statement to clarify that the independent reviews conducted by a financial institution may be performed by the institution's audit department or an independent compliance function within the institution. One commenter also asked the Agencies to state that the proper role of an institution's independent review function is only to confirm that the

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<sup>11</sup> In light of comments, the Agencies have modified the Documentation section of the Statement to clarify that an institution should retain sufficient documentation to establish that it has provided the customer any disclosures concerning an elevated risk CSFT that the institution is otherwise required to provide to the customer.

institution's policies and procedures for elevated risk CSFTs are being followed and that the function should not assess the quality of the decisions made by institution personnel. The Agencies believe that an institution's audit or compliance department should have the flexibility, in appropriate circumstances, to review the decisions made by institution personnel during the review and approval process for elevated risk CSFTs and for this reason have not made the recommended change.

#### **V. Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. § 3506; 5 CFR 1320 Appendix A.1), the Agencies reviewed the Final Statement. The Agencies may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The Agencies previously determined that certain provisions of the Revised Proposed Statement contained information collection requirements. OMB reviewed and approved the information collections contained in the Revised Proposed Statement for the FDIC, OTS, OCC and SEC; and the Board reviewed the Revised Proposed Statement under the authority delegated to the Board by OMB (5 CFR 1320, Appendix A.1).

#### OMB control numbers:

OCC: 1557-0229.

OTS: 1550-0111.

FRB: 7100-0311.

FDIC: 3064-0148.

SEC: 3235-0622.

#### Burden Estimates

## **OCC**

Number of Respondents: 21.

Estimated Time per Response: 25 hours.

Total Estimated Annual Burden: 525 hours.

## **OTS**

Number of Respondents: 5.

Estimated Time per Response: 25 hours.

Total Estimated Annual Burden: 125 hours.

## **Board**

Number of Respondents: 20.

Estimated Time per Response: 25 hours.

Total Estimated Annual Burden: 500 hours.

## **FDIC**

Number of Respondents: 5.

Estimated Time per Response: 25 hours.

Total Estimated Annual Burden: 125 hours.

## **SEC**

Number of Respondents: 5.

Estimated Time per Response: 25 hours.

Total Estimated Annual Burden: 125 hours.

No commenters addressed the Agencies' information collection estimates. The Agencies do not believe that the clarifications included in this Final Statement impact the burden estimates previously developed and approved for these information collections.

The Agencies have a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to:

OCC: You should direct your comments to:

Communications Division, Office of the Comptroller of the Currency, Public Information Room, Mailstop 1-5, Attention: 1557-0229, 250 E Street, SW., Washington, DC 20219. In addition, comments may be sent by fax to (202) 874-4448, or by electronic mail to [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov). You can inspect and photocopy the comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC 20219. You can make an appointment to inspect the comments by calling (202) 874-5043.

Additionally, you should send a copy of your comments to OCC Desk Officer, 1557-0229, by mail to U.S. Office of Management and Budget, 725 17<sup>th</sup> Street, NW., #10235, Washington, DC 20503, or by fax to (202) 395-6974.

You can request additional information or a copy of the collection from Mary Gottlieb, OCC Clearance Officer, or Camille Dickerson, (202) 874-5090, Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906-6518; or send an e-mail to [infocollection.comments@ots.treas.gov](mailto:infocollection.comments@ots.treas.gov). OTS will post comments and the related index on the OTS Internet site at <http://www.treas.gov>. In addition, interested persons may inspect the comments at the

Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment, call (202) 906-5922, send an e-mail to [public.info@ots.treas.gov](mailto:public.info@ots.treas.gov), or send a facsimile transmission to (202) 906-7755.

To obtain a copy of the submission to OMB, contact Marilyn K. Burton at [marilyn.burton@ots.treas.gov](mailto:marilyn.burton@ots.treas.gov), (202) 906-6467, or fax number (202) 906-6518, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552

Board: You may submit comments, identified by FR 4022, by any of the following methods:

- Agency Web site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail:  
[Regs.comments@federalreserve.gov](mailto:Regs.comments@federalreserve.gov). Include docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.
- Mail: Michelle Long, Federal Reserve Board Clearance Officer (202) 452-3829, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551. Telecommunications Device for the Deaf (TDD) users may contact (202) 263-4869, Board of Governors of the Federal Reserve System, Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20<sup>th</sup> and C Streets, NW) between 9 a.m. and 5 p.m. on weekdays.

FDIC: Interested parties are invited to submit written comments to the FDIC concerning the Paperwork Reduction Act implications of this proposal. Such comments should refer to "Complex Structured Finance Transactions, 3064-0148." Comments may be submitted by any of the following methods:

- <http://www.FDIC.gov/regulations/laws/federal/propose.html>.
- E-mail: [comments@FDIC.gov](mailto:comments@FDIC.gov). Include Complex Structured Financial Transactions, 3064-0148 in the subject line of the message.
- Mail: Steven F. Hanft (202) 898-3907, Federal Deposit Insurance Corporation, 550 17<sup>th</sup> Street, NW., Washington, DC 20429.
- Hand Delivery: Comments may be hand-delivered to the guard station at the rear of the 17<sup>th</sup> Street Building (located on F Street), on business days between 7 a.m. and 5 p.m.

SEC: You should direct your comments to: Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, with a copy sent to Nancy M. Morris, Secretary, Securities and

Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090 with reference to File No. S7-08-06.

The Final Statement follows:

**Interagency Statement on Sound Practices Concerning  
Elevated Risk Complex Structured Finance Activities**

**I. Introduction**

Financial markets have grown rapidly over the past decade, and innovations in financial instruments have facilitated the structuring of cash flows and allocation of risk among creditors, borrowers and investors in more efficient ways. Financial derivatives for market and credit risk, asset-backed securities with customized cash flow features, specialized financial conduits that manage pools of assets and other types of structured finance transactions serve important business purposes, such as diversifying risks, allocating cash flows, and reducing cost of capital. As a result, structured finance transactions now are an essential part of U.S. and international capital markets. Financial institutions have played and continue to play an active and important role in the development of structured finance products and markets, including the market for the more complex variations of structured finance products.

When a financial institution participates in a complex structured finance transaction ("CSFT"), it bears the usual market, credit, and operational risks associated with the transaction. In some circumstances, a financial institution also may face

heightened legal or reputational risks due to its involvement in a CSFT. For example, in some circumstances, a financial institution may face heightened legal or reputational risk if a customer's regulatory, tax or accounting treatment for a CSFT, or disclosures to investors concerning the CSFT in the customer's public filings or financial statements, do not comply with applicable laws, regulations or accounting principles. Indeed, in some instances, CSFTs have been used to misrepresent a customer's financial condition to investors, regulatory authorities and others. In these situations, investors have been harmed, and financial institutions have incurred significant legal and reputational exposure. In addition to legal risk, reputational risk poses a significant threat to financial institutions because the nature of their business requires them to maintain the confidence of customers, creditors and the general marketplace.

The Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission (the "Agencies") have long expected financial institutions to develop and maintain robust control infrastructures that enable them to identify, evaluate and address the risks associated with their business activities. Financial institutions also must conduct their activities in accordance with applicable statutes and regulations.

## II. Scope and Purpose of Statement

The Agencies are issuing this Statement to describe the types of risk management principles that we believe may help a financial institution to identify CSFTs that may pose heightened legal or reputational risks to the institution ("elevated risk CSFTs") and

to evaluate, manage and address these risks within the institution's internal control framework.<sup>12</sup>

Structured finance transactions encompass a broad array of products with varying levels of complexity. Most structured finance transactions, such as standard public mortgage-backed securities transactions, public securitizations of retail credit cards, asset-backed commercial paper conduit transactions, and hedging-type transactions involving "plain vanilla" derivatives and collateralized loan obligations, are familiar to participants in the financial markets, and these vehicles have a well-established track record. These transactions typically would not be considered CSFTs for the purpose of this Statement.

Because this Statement focuses on sound practices related to CSFTs that may create heightened legal or reputational risks – transactions that typically are conducted by a limited number of large financial institutions – it will not affect or apply to the vast majority of financial institutions, including most small institutions. As in all cases, a financial institution should tailor its internal controls so that they are appropriate in light of the nature, scope, complexity and risks of its activities. Thus, for example, an institution that is actively involved in structuring and offering CSFTs that may create heightened legal or reputational risk for the institution should have a more formalized and detailed control framework than an institution that participates in these types of

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<sup>12</sup> As used in this Statement, the term "financial institution" or "institution" refers to national banks in the case of the Office of the Comptroller of the Currency; federal and state savings associations and savings and loan holding companies in the case of the Office of Thrift Supervision; state member banks and bank holding companies (other than foreign banking organizations) in the case of the Federal Reserve Board; state nonmember banks in the case of the Federal Deposit Insurance Corporation; and registered broker-dealers and investment advisers in the case of the Securities and Exchange Commission. The U.S. branches and agencies of foreign banks supervised by the Office of the Comptroller, the Federal Reserve Board and the Federal Deposit Insurance Corporation also are considered to be financial institutions for purposes of this Statement.

transactions less frequently. The internal controls and procedures discussed in this Statement are not all inclusive, and, in appropriate circumstances, an institution may find that other controls, policies, or procedures are appropriate in light of its particular CSFT activities.

Because many of the core elements of an effective control infrastructure are the same regardless of the business line involved, this Statement draws heavily on controls and procedures that the Agencies previously have found to be effective in assisting a financial institution to manage and control risks and identifies ways in which these controls and procedures can be effectively applied to elevated risk CSFTs. Although this Statement highlights some of the most significant risks associated with elevated risk CSFTs, it is not intended to present a full exposition of all risks associated with these transactions. Financial institutions are encouraged to refer to other supervisory guidance prepared by the Agencies for further information concerning market, credit, operational, legal and reputational risks as well as internal audit and other appropriate internal controls.

This Statement does not create any private rights of action, and does not alter or expand the legal duties and obligations that a financial institution may have to a customer, its shareholders or other third parties under applicable law. At the same time, adherence to the principles discussed in this Statement would not necessarily insulate a financial institution from regulatory action or any liability the institution may have to third parties under applicable law.

### III. Identification and Review of Elevated Risk Complex Structured Finance Transactions

A financial institution that engages in CSFTs should maintain a set of formal, written, firm-wide policies and procedures that are designed to allow the institution to identify, evaluate, assess, document, and control the full range of credit, market, operational, legal and reputational risks associated with these transactions. These policies may be developed specifically for CSFTs, or included in the set of broader policies governing the institution generally. A financial institution operating in foreign jurisdictions may tailor its policies and procedures as appropriate to account for, and comply with, the applicable laws, regulations and standards of those jurisdictions.<sup>13</sup>

A financial institution's policies and procedures should establish a clear framework for the review and approval of individual CSFTs. These policies and procedures should set forth the responsibilities of the personnel involved in the origination, structuring, trading, review, approval, documentation, verification, and execution of CSFTs. Financial institutions may find it helpful to incorporate the review of new CSFTs into their existing new product policies. In this regard, a financial institution should define what constitutes a "new" complex structured finance product and establish a control process for the approval of such new products. In determining whether a CSFT is new, a financial institution may consider a variety of factors, including whether it contains structural or pricing variations from existing products, whether the product is targeted at a new class of customers, whether it is designed to address a new need of customers, whether it raises significant new legal, compliance or

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<sup>13</sup> In the case of U.S. branches and agencies of foreign banks, these policies, including management, review and approval requirements, should be coordinated with the foreign bank's group-wide policies developed in accordance with the rules of the foreign bank's home country supervisor and should be consistent with the foreign bank's overall corporate and management structure as well as its framework for risk management and internal controls.

regulatory issues, and whether it or the manner in which it would be offered would materially deviate from standard market practices. An institution's policies should require new complex structured finance products to receive the approval of all relevant control areas that are independent of the profit center before the product is offered to customers.

#### **A. Identifying Elevated Risk CSFTs**

As part of its transaction and new product approval controls, a financial institution should establish and maintain policies, procedures and systems to identify elevated risk CSFTs. Because of the potential risks they present to the institution, transactions or new products identified as elevated risk CSFTs should be subject to heightened reviews during the institution's transaction or new product approval processes. Examples of transactions that an institution may determine warrant this additional scrutiny are those that (either individually or collectively) appear to the institution during the ordinary course of its transaction approval or new product approval process to:

- Lack economic substance or business purpose;
- Be designed or used primarily for questionable accounting, regulatory, or tax objectives, particularly when the transactions are executed at year end or at the end of a reporting period for the customer;
- Raise concerns that the client will report or disclose the transaction in its public filings or financial statements in a manner that is materially misleading or inconsistent with the substance of the transaction or applicable regulatory or accounting requirements;

- Involve circular transfers of risk (either between the financial institution and the customer or between the customer and other related parties) that lack economic substance or business purpose;
- Involve oral or undocumented agreements that, when taken into account, would have a material impact on the regulatory, tax, or accounting treatment of the related transaction, or the client's disclosure obligations;<sup>14</sup>
- Have material economic terms that are inconsistent with market norms (e.g., deep "in the money" options or historic rate rollovers); or
- Provide the financial institution with compensation that appears substantially disproportionate to the services provided or investment made by the financial institution or to the credit, market or operational risk assumed by the institution.

The examples listed previously are provided for illustrative purposes only, and the policies and procedures established by financial institutions may differ in how they seek to identify elevated risk CSFTs. The goal of each institution's policies and procedures, however, should remain the same – to identify those CSFTs that warrant additional scrutiny in the transaction or new product approval process due to concerns regarding legal or reputational risks.

Financial institutions that structure or market, act as an advisor to a customer regarding, or otherwise play a substantial role in a transaction may have more information concerning the customer's business purpose for the transaction and any

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<sup>14</sup> This item is not intended to include traditional, non-binding "comfort" letters or assurances provided to financial institutions in the loan process where, for example, the parent of a loan customer states that the customer (i.e., the parent's subsidiary) is an integral and important part of the parent's operations.

special accounting, tax or financial disclosure issues raised by the transaction than institutions that play a more limited role. Thus, the ability of a financial institution to identify the risks associated with an elevated risk CSFT may differ depending on its role.

#### **B. Due Diligence, Approval and Documentation Process for Elevated Risk CSFTs**

Having developed a process to identify elevated risk CSFTs, a financial institution should implement policies and procedures to conduct a heightened level of due diligence for these transactions. The financial institution should design these policies and procedures to allow personnel at an appropriate level to understand and evaluate the potential legal or reputational risks presented by the transaction to the institution and to manage and address any heightened legal or reputational risks ultimately found to exist with the transaction.

Due Diligence. If a CSFT is identified as an elevated risk CSFT, the institution should carefully evaluate and take appropriate steps to address the risks presented by the transaction with a particular focus on those issues identified as potentially creating heightened levels of legal or reputational risk for the institution. In general, a financial institution should conduct the level and amount of due diligence for an elevated risk CSFT that is commensurate with the level of risks identified. A financial institution that structures or markets an elevated risk CSFT to a customer, or that acts as an advisor to a customer or investors concerning an elevated risk CSFT, may have additional responsibilities under the federal securities laws, the Internal Revenue Code, state fiduciary laws or other laws or regulations and, thus, may have greater legal and reputational risk exposure with respect to an elevated risk CSFT than a financial institution that acts only as a counterparty for the transaction. Accordingly, a financial

institution may need to exercise a higher degree of care in conducting its due diligence when the institution structures or markets an elevated risk CSFT or acts as an advisor concerning such a transaction than when the institution plays a more limited role in the transaction.

To appropriately understand and evaluate the potential legal and reputational risks associated with an elevated risk CSFT that a financial institution has identified, the institution may find it useful or necessary to obtain additional information from the customer or to obtain specialized advice from qualified in-house or outside accounting, tax, legal, or other professionals. As with any transaction, an institution should obtain satisfactory responses to its material questions and concerns prior to consummation of a transaction.<sup>15</sup>

In conducting its due diligence for an elevated risk CSFT, a financial institution should independently analyze the potential risks to the institution from both the transaction and the institution's overall relationship with the customer. Institutions should not conclude that a transaction identified as being an elevated risk CSFT involves minimal or manageable risks solely because another financial institution will participate in the transaction or because of the size or sophistication of the customer or counterparty. Moreover, a financial institution should carefully consider whether it would be appropriate to rely on opinions or analyses prepared by or for the customer concerning any significant accounting, tax or legal issues associated with an elevated risk CSFT.

Approval Process. A financial institution's policies and procedures should provide that CSFTs identified as having elevated legal or reputational risk are reviewed

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<sup>15</sup> Of course, financial institutions also should ensure that their own accounting for transactions complies with applicable accounting standards, consistently applied.

and approved by appropriate levels of control and management personnel. The designated approval process for such CSFTs should include representatives from the relevant business line(s) and/or client management, as well as from appropriate control areas that are independent of the business line(s) involved in the transaction. The personnel responsible for approving an elevated risk CSFT on behalf of a financial institution should have sufficient experience, training and stature within the organization to evaluate the legal and reputational risks, as well as the credit, market and operational risks to the institution.

The institution's control framework should have procedures to deliver the necessary or appropriate information to the personnel responsible for reviewing or approving an elevated risk CSFT to allow them to properly perform their duties. Such information may include, for example, the material terms of the transaction, a summary of the institution's relationship with the customer, and a discussion of the significant legal, reputational, credit, market and operational risks presented by the transaction.

Some institutions have established a senior management committee that is designed to involve experienced business executives and senior representatives from all of the relevant control functions within the financial institution (including such groups as independent risk management, tax, accounting, policy, legal, compliance, and financial control) in the oversight and approval of those elevated risk CSFTs that are identified by the institution's personnel as requiring senior management review and approval due to the potential risks associated with the transactions. While this type of management committee may not be appropriate for all financial institutions, a financial institution

should establish processes that assist the institution in consistently managing the review and approval of elevated risk CSFTs on a firm-wide basis.<sup>16</sup>

If, after evaluating an elevated risk CSFT, the financial institution determines that its participation in the CSFT would create significant legal or reputational risks for the institution, the institution should take appropriate steps to address those risks. Such actions may include declining to participate in the transaction, or conditioning its participation upon the receipt of representations or assurances from the customer that reasonably address the heightened legal or reputational risks presented by the transaction. Any representations or assurances provided by a customer should be obtained before a transaction is executed and be received from, or approved by, an appropriate level of the customer's management. A financial institution should decline to participate in an elevated risk CSFT if, after conducting appropriate due diligence and taking appropriate steps to address the risks from the transaction, the institution determines that the transaction presents unacceptable risk to the institution or would result in a violation of applicable laws, regulations or accounting principles.

Documentation. The documentation that financial institutions use to support CSFTs is often highly customized for individual transactions and negotiated with the customer. Careful generation, collection and retention of documents associated with elevated risk CSFTs are important control mechanisms that may help an institution monitor and manage the legal, reputational, operational, market, and credit risks

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<sup>16</sup> The control processes that a financial institution establishes for CSFTs should take account of, and be consistent with, any informational barriers established by the institution to manage potential conflicts of interest, insider trading or other concerns.

associated with the transactions. In addition, sound documentation practices may help reduce unwarranted exposure to the financial institution's reputation.

A financial institution should create and collect sufficient documentation to allow the institution to:

- Document the material terms of the transaction;
- Enforce the material obligations of the counterparties;
- Confirm that the institution has provided the customer any disclosures concerning the transaction that the institution is otherwise required to provide; and
- Verify that the institution's policies and procedures are being followed and allow the internal audit function to monitor compliance with those policies and procedures.

When an institution's policies and procedures require an elevated risk CSFT to be submitted for approval to senior management, the institution should maintain the transaction-related documentation provided to senior management as well as other documentation, such as minutes of the relevant senior management committee, that reflect senior management's approval (or disapproval) of the transaction, any conditions imposed by senior management, and the factors considered in taking such action. The institution should retain documents created for elevated risk CSFTs in accordance with its record retention policies and procedures as well as applicable statutes and regulations.

### **C. Other Risk Management Principles for Elevated Risk CSFTs**

General Business Ethics. The board and senior management of a financial institution also should establish a "tone at the top" through both actions and formalized

policies that sends a strong message throughout the financial institution about the importance of compliance with the law and overall good business ethics. The board and senior management should strive to create a firm-wide corporate culture that is sensitive to ethical or legal issues as well as the potential risks to the financial institution that may arise from unethical or illegal behavior. This kind of culture coupled with appropriate procedures should reinforce business-line ownership of risk identification, and encourage personnel to move ethical or legal concerns regarding elevated risk CSFTs to appropriate levels of management. In appropriate circumstances, financial institutions may also need to consider implementing mechanisms to protect personnel by permitting the confidential disclosure of concerns.<sup>17</sup> As in other areas of financial institution management, compensation and incentive plans should be structured, in the context of elevated risk CSFTs, so that they provide personnel with appropriate incentives to have due regard for the legal, ethical and reputational risk interests of the institution.

Reporting. A financial institution's policies and procedures should provide for the appropriate levels of management and the board of directors to receive sufficient information and reports concerning the institution's elevated risk CSFTs to perform their oversight functions.

Monitoring Compliance with Internal Policies and Procedures. The events of recent years evidence the need for an effective oversight and review program for elevated risk CSFTs. A financial institution's program should provide for periodic independent reviews of its CSFT activities to verify and monitor that its policies and controls relating

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<sup>17</sup> The agencies note that the Sarbanes-Oxley Act of 2002 requires companies listed on a national securities exchange or inter-dealer quotation system of a national securities association to establish procedures that enable employees to submit concerns regarding questionable accounting or auditing matters on a confidential, anonymous basis. See 15 U.S.C. 78j-1(m).

to elevated risk CSFTs are being implemented effectively and that elevated risk CSFTs are accurately identified and received proper approvals. These independent reviews should be performed by appropriately qualified audit, compliance or other personnel in a manner consistent with the institution's overall framework for compliance monitoring, which should include consideration of issues such as the independence of reviewing personnel from the business line. Such monitoring may include more frequent assessments of the risk arising from elevated risk CSFTs, both individually and within the context of the overall customer relationship, and the results of this monitoring should be provided to an appropriate level of management in the financial institution.

Audit. The internal audit department of any financial institution is integral to its defense against fraud, unauthorized risk taking and damage to the financial institution's reputation. The internal audit department of a financial institution should regularly audit the financial institution's adherence to its own control procedures relating to elevated risk CSFTs, and further assess the adequacy of its policies and procedures related to elevated risk CSFTs. Internal audit should periodically validate that business lines and individual employees are complying with the financial institution's standards for elevated risk CSFTs and appropriately identifying any exceptions. This validation should include transaction testing for elevated risk CSFTs.

Training. An institution should identify relevant personnel who may need specialized training regarding CSFTs to be able to effectively perform their oversight and review responsibilities. Appropriate training on the financial institution's policies and procedures for handling elevated risk CSFTs is critical. Financial institution personnel involved in CSFTs should be familiar with the institution's policies and procedures

concerning elevated risk CSFTs, including the processes established by the institution for identification and approval of elevated risk CSFTs and new complex structured finance products and for the elevation of concerns regarding transactions or products to appropriate levels of management. Financial institution personnel involved in CSFTs should be trained to identify and properly handle elevated risk CSFTs that may result in a violation of law.

#### IV. Conclusion

Structured finance products have become an essential and important part of the U.S. and international capital markets, and financial institutions have played an important role in the development of structured finance markets. In some instances, however, CSFTs have been used to misrepresent a customer's financial condition to investors and others, and financial institutions involved in these transactions have sustained significant legal and reputational harm. In light of the potential legal and reputational risks associated with CSFTs, a financial institution should have effective risk management and internal control systems that are designed to allow the institution to identify elevated risk CSFTs, to evaluate, manage and address the risks arising from such transactions, and to conduct those activities in compliance with applicable law.

Dated: December 12, 2006.

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John C. Dugan,  
Comptroller of the Currency.

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Dated: December 21, 2006.

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By the Office of Thrift Supervision.  
Scott M. Polakoff,  
Deputy Director & Chief Operating Officer

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By order of the Board of Governors of the Federal Reserve System, December 20, 2006.

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Jennifer J. Johnson,  
Secretary of the Board.

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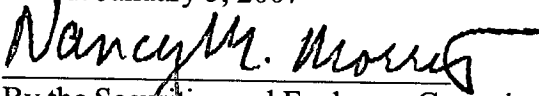
Dated at Washington, DC, the 22nd day of December, 2006.

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By order of the Federal Deposit Insurance Corporation.  
Robert E. Feldman,  
Executive Secretary.

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Dated: January 5, 2007

  
By the Securities and Exchange Commission  
Nancy M. Morris  
Secretary

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 55046 / January 5, 2007

Admin. Proc. File No. 3-11652r

In the Matter of the Application of

ROONEY A. SAHAI  
c/o Andrew Seewald, Esq.  
46 Bayard Street, Suite 216  
New Brunswick, NJ 08901

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY  
PROCEEDINGS

Violation of Conduct Rules

Failure to Provide Requested Information

Sanctions

Associated person of association member failed to give complete and timely responses to requests for information. Held, association's sanctions sustained in part.

APPEARANCES:

Andrew Seewald, for Rooney A. Sahai.

Marc Menchel, Alan B. Lawhead, and Andrew Love, for NASD.

Appeal filed: March 27, 2006  
Last brief received: July 3, 2006

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## I.

Rooney A. Sahai, an associated person with The Key Group, Inc. ("Key Group"), an NASD member firm, again appeals from NASD disciplinary action. NASD's decision on remand from the Commission bars Sahai in all capacities for violating NASD Rule 8210, which obliges associated persons to provide information to NASD in the course of an investigation. 1/ In his first appeal, Sahai sought review of NASD disciplinary action that found that Sahai was responsible for five forged customer signatures, an unauthorized transaction in one customer's account, and a failure to provide information requested by NASD pursuant to NASD Rule 8210. NASD barred Sahai for the forgery violations, barred him separately for the failure to provide information, and determined that a \$5,000 fine would have been an appropriate sanction for the unauthorized transaction, but declined to impose the fine because Sahai had been barred. 2/ We set aside NASD's findings of violation with respect to the forgeries, sustained its findings with respect to the unauthorized transaction and the failure to provide information, and remanded to NASD for consideration of the appropriate sanctions in light of our opinion. 3/

On remand, NASD barred Sahai for his failure to provide information. NASD also found that a \$5,000 fine would have been an appropriate sanction for the unauthorized transaction, although it again declined to impose the fine because Sahai had been barred. Sahai appeals the bar imposed for the failure to provide information. We base our findings on an independent review of the record.

## II.

To assess the sanctions imposed by NASD on remand, we need to review the facts. In 1999 and 2000, Sahai was registered as a limited representative - investment company and variable contracts products representative with Key Group, an NASD member firm. Sahai worked out of his home. In 2001, NASD began an investigation into customer complaints that the writing and signatures on documents related to securities transactions were forged and that Sahai executed an unauthorized transaction. NASD also examined whether Sahai had engaged in undisclosed outside business activity in violation of NASD rules. 4/

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1/ NASD Rule 8210(a).

2/ It is NASD policy not to impose monetary sanctions on a respondent who has been barred where there are no customer losses, as in violations of Rule 8210. NASD Sanction Guidelines, 10 (2006 ed.).

3/ Rooney A. Sahai, Securities Exchange Act Rel. No. 51549 (April 15, 2005), 85 SEC Docket 862.

4/ See, e.g. NASD Conduct Rule 3030, which provides that no associated person "shall be employed by, or accept compensation from, any other person as a result of any business (continued...)

Sahai participated in four hours of on-the-record investigative testimony conducted by NASD staff on February 15, 2001. At that time, Sahai stated with respect to the forgery allegations that the writing on several customer documents was not his. He suggested that any one of three former administrative employees could have completed and executed the documents. Although Sahai could not identify the employees at that time, he promised to review his records, check with his accountant, and provide the requested information.

Later that day, NASD staff sent Sahai its first request pursuant to NASD Rule 8210 for the names, addresses, and related information of the three former employees who could have signed the customers' names. The staff intended to confirm the existence of the individuals, locate them, and question them about their roles, if any, in the alleged forgeries. In the same request, the staff also sought documents and information concerning two corporations, Amer-Asian Securities, Inc. ("AAS") and Physicians Financial Services, Inc. ("PFS"), to determine whether Sahai's activities with these entities violated NASD restrictions on outside business activities. The staff set a March 1, 2001, response date for this request and later agreed to a request from Sahai's counsel that the response date be extended to March 6.

Sahai did not provide NASD staff with any documents or information on March 6, 2001. On March 19, the staff sent a second request for the documents and information first requested on February 15. On March 26, a week after NASD's second request and six weeks after the initial request, Sahai identified Patrick Haas, Deepa Patel, and Chris Marra as the employees to whom he referred in his February 15 testimony. <sup>5/</sup> Sahai stated that he had not been able to locate the employees' addresses and that the employees had been terminated because Sahai was not "satisfied" with their performance. Sahai objected to the requests with respect to AAS and PFS on the grounds that they were irrelevant and burdensome. Notwithstanding his objections, Sahai provided a certificate of incorporation and an unsigned organizational resolution for AAS and stated that he had no corporate documents for PFS. Sahai represented that he was the sole shareholder for both corporations and that he disclosed his activities with both corporations to officers of Key Group.

On March 29, 2001, NASD staff repeated the February 15 requests noting that the March 26 response was incomplete. The staff also reminded Sahai that Rule 8210 imposes an obligation on him to provide information requested by the staff. The staff set a response date of April 9 for this request. On April 3, Sahai represented to the staff that he had provided all the documents in his files that were responsive to the February 15 request. Sahai stated that,

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<sup>4/</sup> (...continued)  
activity . . . outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member."

<sup>5/</sup> Sahai responded to all of the information requests through his former counsel, Steven Mannion. NASD subsequently required Sahai to sign the responses initially tendered over Mannion's signature on March 26, April 3, and April 18, 2001. Sahai provided the signatures as directed on May 10, 2001.

although he would continue to search for responsive documents, the staff should consider his response to be complete. On April 18, Sahai amended his response to the information request by providing the certificate of incorporation for PFS. By a separate letter of the same date, Steven Mannion, then counsel for Sahai, confirmed that the staff wanted only the addresses and telephone numbers of Sahai's former employees. Although in that letter Mannion questioned NASD's authority to require Sahai to compel third parties (AAS, PFS) to produce information in response to NASD staff requests, Sahai nonetheless provided the corporate documents that NASD requested.

On April 23, 2001, NASD staff requested, in connection with its investigation of possible unauthorized transactions by Sahai, that Sahai explain his February 15 investigative testimony with respect to certain authorizations signed by one of Sahai's customers. In the same letter, the staff reiterated its request for the addresses of Sahai's former employees and required a response by May 7. On April 25, Sahai provided a Ridgefield, New Jersey address for one of the former employees, Patrick Haas. 6/

Sahai stated further that he was unable to locate addresses for the other two former employees because the computer address book in which he maintained the records for those employees had malfunctioned in 2000. The type or exact effect of the malfunction does not appear from the record. Sahai's then-current administrative assistant testified that there had been a computer malfunction -- which she testified may have been in 2001 rather than 2000 -- that destroyed all the records Sahai kept in the address-book program. She testified further that she reconstructed some employee records from paper copies in office files. She did not know whether each employee had such paper records. Mannion testified as a fact witness that he became aware of the malfunction contemporaneously with his drafting of the April 25 letter. Mannion also said that he was not surprised by the malfunction given the state of Sahai's computer equipment.

On April 27, 2001, NASD staff requested that Sahai provide them with his source for Haas' address, as well as payroll records for AAS and for all of Sahai's employees. In the same letter, the staff also requested that Sahai provide NASD with social security numbers and employment applications for Haas, Patel, and Marra. The staff required a response by May 11.

On May 10, 2001, NASD staff reiterated its April 23 information request and required a response by May 21. On the same date, Mannion sent Sahai's signatures on his March 26, April 3, and April 18 responses. The parties agree that the two May 10 letters crossed in the mail. With respect to the April 23 request, Mannion asked for copies of the exhibits referred to in the request so that Sahai could provide responsive information about the customer authorizations.

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6/ NASD investigators were unable to contact Haas using the address Sahai provided. There is insufficient information in the record to explain why Haas could not be contacted at that address.

Mannion provided the address for Haas a second time and stated that addresses for the other employees were unavailable.

On May 14, 2001, NASD staff reiterated its April 27 request and set a response date of May 24. On May 14, Mannion wrote to NASD staff asking why the staff had sent him a letter saying he had not complied with the May 21 response date when the staff's deadline had not expired. Although it is not explicit from the letter itself, Mannion testified at the hearing that this letter was a response to the May 14 request from NASD. Mannion also testified that, to his knowledge, Sahai produced "all the information that Mr. Sahai could locate or had located on his behalf by his staff."

### III.

Section 19(e)(2) of the Securities Exchange Act of 1934 governs our consideration of Sahai's appeal from NASD's decision on remand. <sup>7/</sup> Section 19(e)(2) provides that the Commission will sustain NASD's sanctions unless it finds, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. <sup>8/</sup>

Rule 8210 is an essential tool for NASD's enforcement responsibilities under the Securities Exchange Act of 1934. As we stated in our first opinion, "[i]t is well settled that, because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines the NASD's ability to carry out its regulatory mandate." <sup>9/</sup> The Commission has taken a broad view of the scope of Rule 8210, finding, for example, that recipients of requests under Rule 8210 must respond to the requests or explain why they cannot <sup>10/</sup> and may not set conditions on their compliance. <sup>11/</sup> Nor is NASD required to justify its information requests. <sup>12/</sup>

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<sup>7/</sup> 15 U.S.C. § 78s(e)(2).

<sup>8/</sup> Sahai does not claim, and the record does not show, that NASD's action imposed an unnecessary or inappropriate burden on competition.

<sup>9/</sup> Sahai, 85 SEC Docket at 873 n.24. See, e.g. Joseph G. Chiulli, 54 S.E.C. 515, 524 (2000).

<sup>10/</sup> Robert Fitzpatrick, 55 S.E.C. 419, 424 (2001), petition denied, 63 Fed. Appx. 20 (2d Cir. 2003).

<sup>11/</sup> Michael David Borth, 51 S.E.C. 178, 182 (1992).

<sup>12/</sup> Joseph Patrick Hannan, 53 S.E.C. 859, 860 (1998).

NASD in its Sanction Guidelines distinguishes two classes of violations of Rule 8210. If a member or associated person fails to "respond in any manner" to a request pursuant to Rule 8210, the maximum recommended sanction is a bar or a \$50,000 fine. <sup>13/</sup> If the violation is one in which "mitigation exists, or the person did not respond in a timely manner" to a request pursuant to Rule 8210, the maximum recommended sanction is a two-year suspension and a \$25,000 fine. <sup>14/</sup>

NASD asserts that Sahai failed to respond "in any manner" to its letters of April 27 and May 14. Those letters asked for Sahai's source for Haas' address, AAS payroll records, and payroll records for all of Sahai's employees, as well as Haas', Marra's, and Patel's social security numbers, payroll records (or an explanation of how they were paid), and any employment applications. In arguing that a bar of Sahai is appropriate, NASD directs our attention to the Sanction Guidelines' Principal Considerations 1 and 2 for Rule 8210 violations, which require, respectively, evaluation of the nature of the information sought and, if the information was eventually produced, how much time and effort were required by NASD staff to obtain it. <sup>15/</sup> NASD argues that the information was critical to its investigation of the alleged forgery and was not provided. Moreover, to the extent information was provided, NASD argues that it was as the result of repeated requests and regulatory pressure, and that the delays in providing the information were egregious.

We agree that Sahai did not produce information or documents in response to the April 27 and May 14 requests for information. We agree further that the information requested was important to NASD's investigation of whether someone in Sahai's office executed, or was directed to execute, the allegedly forged documents. We have long said that if a respondent is unable to provide the information requested, there remains a duty to explain that inability. <sup>16/</sup>

In this case, we would have expected such an explanation from Sahai to detail his efforts to obtain the information requested. Sahai stated only that he had searched his files and found no further documents. He did not identify the files reviewed. Moreover, despite Sahai's representation at his investigatory testimony that he would contact his accountant for information with respect to the former employees, there is no indication that he subsequently did so.

We must note, however, that, as Sahai asserts, he did comply with five of the seven requests to some extent. Sahai testified in an on-the-record interview and provided NASD staff with the corporate documentation of AAS and PFS requested in the February 15 request. Sahai also provided the names of all three former employees and the address of one of them in response

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<sup>13/</sup> NASD Sanction Guidelines, 39 (2006 ed.)

<sup>14/</sup> Id.

<sup>15/</sup> Id.

<sup>16/</sup> Richard J. Rouse, 51 S.E.C. 581, 584 (1993).

to the February 15 request. He represented through counsel that he had no other information in his files relevant to the staff's inquiry. On the basis of the record, we cannot say that Sahai did not respond "in any manner." Imposing a bar as a sanction for that conduct, as NASD did on remand, is excessive when considered with the Sanction Guidelines, and, pursuant to Exchange Act Section 19(e)(2), we set the bar aside.

Application of the Sanction Guidelines' considerations suggests that Sahai's conduct should be sanctioned at the high end of the range because of his minimal and dilatory cooperation. Accordingly, we suspend Sahai for the longest period recommended in the Sanction Guidelines, two years. <sup>17/</sup> Moreover, because Sahai is no longer subject to a bar, we find it appropriate to impose the \$5,000 fine identified by NASD as appropriate for the unauthorized transaction, but not imposed.

Sahai claims that, by barring him for a violation of Rule 8210, NASD has violated the Eighth and Fourteenth Amendments to the United States Constitution by imposing an excessive sanction. Courts that have considered whether the limitations the Constitution imposes on governmental actors limit NASD's actions have concluded that, under these circumstances, NASD is a private actor and is not bound by the limitations imposed by the Eighth and Fourteenth Amendments. <sup>18/</sup> The fact that NASD has authority under Section 15A(b)(7) of the Securities Exchange Act of 1934 to discipline its members and may impose remedial sanctions does not convert it into a state actor. <sup>19/</sup>

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<sup>17/</sup> Sahai claims that he has been licensed for fifteen years with a clean disciplinary record and has suffered loss of reputation, income, and peace of mind as result of NASD's bar. Sahai also notes that NASD's order has operated as a "de facto" bar since its entry and further sanctions would be "excessive." We have considered these factors and, on balance, consider that a significant suspension is warranted by the facts in the record.


<sup>18/</sup> See, e.g. Perpetual Securities, Inc. v. Tang, 290 F.3d 132 (2d Cir. 2002); Desiderio v. NASD, 191 F.3d 198 (2d Cir. 1999).

<sup>19/</sup> 15 U.S.C. § 78o-3(b)(7). As the Perpetual court stated, "even if NASD is a private actor, 'state action may be found if, though only if, there is such a "close nexus between the State and the challenged action" that seemingly private behavior "may be fairly treated as that of the state itself".'" Perpetual Securities, Inc., 290 F.3d at 137 (citations omitted). There is nothing in the record here to suggest any nexus between NASD and any state actor.

Sahai further asserts that he was treated more harshly than others similarly situated because of his national origin. Sahai has presented no evidence of such discrimination, and we discern none in the record. We have reduced the sanction for the reasons set forth above. 20/

An appropriate order will issue. 21/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH, and CASEY).

  
Nancy M. Morris  
Secretary

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20/ If Sahai is alleging that he has been subject to unlawful selective prosecution in NASD's initiation and pursuit of this action against him, Sahai must prove that he was singled out for enforcement action while others similarly situated were not and that his selection as a target for enforcement was based on an unjustifiable consideration such as his race, religion, national origin, or the exercise of constitutionally protected rights. United States v. Huff, 959 F.2d 731, 735 (8th Cir. 1992); Maximo Justo Guevara, 54 S.E.C. 655, 665 (2000), pet'n denied, 47 Fed. Appx. 198 (3d Cir. 2002) (Table); Kim G. Girdner, 50 S.E.C. 221, 227 (1990). Sahai has made no showing on the record before us that he has been subject to such improper prosecutorial decisions. In fact, we note that the investigation and subsequent enforcement action was commenced in response to complaints from Sahai's customers.

21/ We have considered all of the arguments advanced by the parties. 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  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 55046 / January 5, 2007

Admin. Proc. File No. 3-11652r

In the Matter of the Application of

ROONEY A. SAHAI  
c/o Andrew Seewald, Esq.  
46 Bayard Street, Suite 216  
New Brunswick, NJ 08901

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING SANCTIONS IN PART

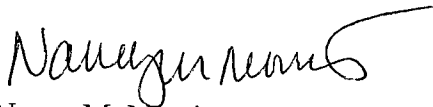
On the basis of the Commission's opinion issued this day, it is

ORDERED that the bar from association with any NASD member in all capacities imposed by NASD on Rooney A. Sahai be, and it hereby is, set aside; and it is further

ORDERED that Rooney A. Sahai be suspended in all capacities for two years, the suspension to commence on the date of this order; and it is further

ORDERED that a fine of \$5,000 be, and it hereby is, imposed on Rooney A. Sahai.

By the Commission.

  
Nancy M. Morris  
Secretary

Commissioner Nazareth  
Not Participating

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 55054 / January 8, 2007

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 2533 / January 8, 2007

ADMINISTRATIVE PROCEEDING

File No. 3-12523

In the Matter of

David A. Monaghan, CPA,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO RULE  
102(e) OF THE COMMISSION'S RULES OF  
PRACTICE, 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 against David A. Monaghan ("Respondent" or "Monaghan") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

II.

<sup>1</sup> 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, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Document 4 of 54

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.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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:

A. Monaghan, age 38, is and has been a certified public accountant holding an inactive license to practice in the State of Missouri. Monaghan served as the Vice President of Finance, the most senior financial officer for Northwestern Services Group, Inc., ("NSG"), formerly a wholly owned subsidiary of Northwestern Corporation ("Northwestern"), from January 2001 until June 2002. Monaghan served as the Vice President of Financial Planning and Reporting for NSG from June 2002 through July 2003.

B. Northwestern was, at all relevant times, a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. Northwestern, through NSG, operated a public utility business serving the Upper Midwest region. Northwestern Communications Solutions ("NCS") was an operating division of NSG through June 2002. At all relevant times, Northwestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On December 14, 2006 a final judgment was entered against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-11 thereunder, in the civil action entitled Securities and Exchange Commission v. Bart A. Thielbar et al., Civil Action Number 06-4253 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that Respondent fraudulently participated in misstating the financial statements of NCS. The Commission's Complaint further alleged that after consolidation, these misstatements resulted in Northwestern materially overstating its income for the quarter ended December 31, 2001, as reported in its annual report on Form 10-K for the fiscal year ended December 31, 2001. Specifically, the Complaint alleged that Respondent instructed his subordinates to improperly reclassify unsubstantiated assets to goodwill rather than making appropriate charges to the income statement.

#### IV.

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

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

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After three years 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 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.

C. 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.

By the Commission.

Nancy M. Morris  
Secretary

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

Commissioner Nazareth  
Not Participating

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55055 / January 8, 2007

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 2534 / January 8, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12524

In the Matter of

Cary B. Griswold, CPA,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO RULE  
102(e) OF THE COMMISSION'S RULES OF  
PRACTICE, 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 against Cary B. Griswold ("Respondent" or "Griswold") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

<sup>1</sup> 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, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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## 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 her and the subject matter of these proceedings, and the findings contained in Section III.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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:

A. Griswold, age 29, obtained her certificate as a certified public accountant in March 2001, and obtained her permit to practice in the state of South Dakota on July 1, 2002. She served as the primary staff accountant for Northwestern Communications Solutions ("NCS"), an operating division of a subsidiary of Northwestern Corporation ("Northwestern"), from April 2001 until August 2003.

B. Northwestern was, at all relevant times, a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. Northwestern, through a wholly owned former subsidiary, operated a public utility business serving the Upper Midwest region. At all relevant times, Northwestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On December 14, 2006 a final judgment was entered against Respondent, permanently enjoining her from future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, and aiding and abetting 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, in the civil action entitled Securities and Exchange Commission v. Bart A. Thielbar et al., Civil Action Number 06-4253 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that Respondent, at the direction of her supervisors, participated in misstating the financial statements of NCS. After consolidation, these misstatements resulted in Northwestern materially overstating its income or materially understating its loss in its annual report on Form 10-K for the fiscal year ended December 31, 2001, and in its quarterly reports on Form 10-Q for the first two quarters of fiscal year 2002. The Complaint alleged that the Respondent improperly reclassified unsubstantiated assets to goodwill rather than making appropriate charges to the income statement. In addition, the Complaint alleged that Respondent improperly recorded revenue for transactions before

NCS had arrangements with customers, and recorded revenue prematurely before the revenue was earned.

#### IV.

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

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

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After two years from the date of this order, Respondent may request that the Commission consider her 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 her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she 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 she is associated, is registered with the Public Company Accounting 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 she 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 her 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.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is current and she 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.

By the Commission.

Nancy M. Morris  
Secretary

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

Commissioner Nazareth  
Not Participating

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55056 / January 8, 2007

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 2535 / January 8, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12525

In the Matter of

Jana L. Quam, CPA,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO RULE  
102(e) OF THE COMMISSION'S RULES OF  
PRACTICE, 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 against Jana L. Quam ("Respondent" or "Quam") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

<sup>1</sup> 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, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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## 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 her and the subject matter of these proceedings, and the findings contained in Section III.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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:

A. Quam, age 49, is and has been a certified public accountant holding an inactive license to practice in the State of South Dakota. She served as Controller of Northwestern Services Group, Inc., ("NSG"), formerly a wholly owned subsidiary of Northwestern Corporation ("Northwestern"), from June 1999 until June 2002.

B. Northwestern was, at all relevant times, a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. Northwestern, through NSG, operated a public utility business serving the Upper Midwest region. Northwestern Communications Solutions ("NCS") was an operating division of NSG through June 2002. At all relevant times, Northwestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On December 14, 2006 a final judgment was entered against Respondent, permanently enjoining her from future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-11 thereunder, in the civil action entitled Securities and Exchange Commission v. Bart A. Thielbar et al., Civil Action Number 06-4253 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that Respondent participated in misstating the financial statements of NCS. After consolidation, these misstatements resulted in Northwestern materially overstating its income for the quarter ended December 31, 2001, as reported in its annual report on Form 10-K for the fiscal year ended December 31, 2001. Specifically, the Complaint alleged that Respondent, at the direction of her supervisor, instructed her subordinate to improperly reclassify unsubstantiated assets to goodwill rather than making appropriate charges to the income statement.

#### IV.

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

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

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After two years from the date of this order, Respondent may request that the Commission consider her 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 her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she 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 she is associated, is registered with the Public Company Accounting 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 she 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 her 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.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is current and she 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.

By the Commission.

Nancy M. Morris  
Secretary

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

*Commissioner Attkisson  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 8767 / January 9, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12526

In the Matter of

DEUTSCHE BANK TRUST  
COMPANY AMERICAS,  
THE BANK OF NEW YORK,  
and WILMINGTON TRUST  
COMPANY,

Respondents.

ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Deutsche Bank Trust Company Americas, The Bank of New York, and Wilmington Trust Company (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement ("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 Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 ("Order"), as set forth below.

*Document 7 of 54*

### III.

On the basis of this Order and Respondents' Offers, the Commission finds that:<sup>1</sup>

#### A. RESPONDENTS

Respondent **Deutsche Bank Trust Company Americas ("DBTCA")**, headquartered in New York, New York, is a New York State-chartered bank that is a member of the Federal Reserve System ("Federal Reserve") and, as such, is regulated by the Federal Reserve and the New York State Banking Department. DBTCA provides banking and bank-eligible securities services.

Respondent **The Bank of New York ("BNY")**, headquartered in New York, New York, is a New York State-chartered bank that is a member of the Federal Reserve and, as such, is regulated by the Federal Reserve and the New York State Banking Department. BNY provides banking and bank-eligible securities services.

Respondent **Wilmington Trust Company ("WTC")**, headquartered in Wilmington, Delaware, is a Delaware State-chartered bank that is a member of the Federal Deposit Insurance Corporation ("FDIC") and, as such, is regulated by the FDIC and the Delaware State Banking Department. WTC provides banking and bank-eligible services.

#### B. SUMMARY

As part of their businesses, Respondents act as auction agents in the auctioning of auction rate securities. From at least January 1, 2003 through June 30, 2004, in connection with certain auctions, each Respondent accepted initial or revised bids after submission deadlines and allowed broker-dealers to intervene in auctions. In certain instances, this conduct also affected the rate paid on the auction rate securities. As a result of this conduct, each Respondent caused violations of Section 17(a)(2) of the Securities Act.

#### C. FACTS

##### 1. The Auction Rate Securities Market

Auction rate securities are municipal bonds, corporate bonds, and preferred stocks with interest rates or dividend yields that are periodically re-set through auctions, typically every 7, 14, 28, or 35 days. Auction rate bonds are usually issued with maturities of 30 years, but the maturities can range from 5 years to perpetuity. Broker-dealers often market auction rate securities to issuers as an alternative variable rate financing vehicle, and to investors as an alternative to

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<sup>1</sup> 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.

money market funds. Auction rate securities were first developed in 1984, and the auction rate securities market has grown to more than \$200 billion.

a. Auction Mechanics. Auction rate securities are auctioned at par so the return on the investment to the investor and the cost of financing to the issuer between auction dates is determined by the interest rate or dividend yield set through the auctions.<sup>2</sup> According to the disclosure documents (the prospectus or official statement) for each security, the interest rate or dividend yield is set through an auction (commonly referred to as a "Dutch" auction) in which bids with successively higher rates are accepted until all of the securities in the auction are sold. Investors can only submit the following types of orders: 1) a "hold" order, which is the default order for current investors (i.e., the order that is entered for a current holder if the holder takes no action), where a current investor will keep the securities at the rate at which the auction clears; 2) a "hold-at-rate" bid, where a current investor will keep all or a pro-rated amount of the securities if the clearing rate is at, or all of the securities if the clearing rate is above, the specified rate; 3) a "sell" order, where a current investor will sell the securities regardless of the clearing rate; or 4) a "buy" bid, where a prospective investor, or a current investor who wants more securities, will buy securities if the clearing rate is at or above the specified rate. Disclosure documents often state that an investor's order is an irrevocable offer.

The final rate at which all of the securities are sold is the "clearing rate," which applies to all of the securities in the auction until the next auction. Bids with the lowest rate and then successively higher rates are accepted until all of the sell orders are filled. The clearing rate is the lowest rate bid sufficient to cover all of the securities for sale in the auction.<sup>3</sup> If there are not enough bids to cover the securities for sale, then the auction fails, the issuer pays an above-market rate set by a pre-determined formula described in the disclosure documents, and all of the current holders continue to hold the securities, with minor exceptions. If all of the current holders of the security elect to hold their positions without bidding a particular rate, then the clearing rate is the all-hold rate, a below-market rate set by a formula described in the disclosure documents.

b. Broker-Dealers' Role in Auctions. The issuer of each security selects one or more broker-dealers to underwrite the offering and/or manage the auction process. Investors can only submit orders through the selected broker-dealers. The issuer pays an annualized fee to each broker-dealer engaged to manage an auction (typically 25 basis points for the par value of the securities that it manages). The issuer also selects an auction agent to receive the orders from the broker-dealers and calculate the clearing rate for the auction.

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<sup>2</sup> Between auctions, investors might be able to buy or sell auction rate securities in the secondary market at prices greater than, equal to, or less than par.

<sup>3</sup> For example, suppose \$100,000 of securities were for sale and the auction received four buy bids. Bid A was for \$50,000 at 1.10%, Bid B was for \$50,000 at 1.15%, Bid C was for \$50,000 at 1.15%, and Bid D was for \$25,000 at 1.20%. Under these circumstances, the "clearing rate" would be 1.15%, meaning all of the securities in the auction would pay interest at a rate of 1.15% until the next auction. Bid A would be allocated \$50,000, Bids B and C would receive pro-rata allocations (\$25,000 each), and Bid D would receive no allocation.

Auction agency agreements, the material terms of which are described in the disclosure documents, generally specify a time when orders must be provided to the auction agent (the "submission deadline"). Some broker-dealers allow investors to submit orders to the broker-dealers up until the submission deadline. Many broker-dealers, however, have an internal deadline by which investors must submit their orders to the broker-dealer. This internal deadline allows the broker-dealer sufficient time to process and submit the orders to the auction agent by the submission deadline set forth in the auction agency agreements. Regardless of the deadlines they use, the broker-dealers must submit the orders to the auction agent by the submission deadline.

c. Auction Agents' Role in Auctions. The issuer pays the auction agent a fee (typically 1 basis point for the principal outstanding amount of securities on an annualized basis) to administer auctions in accordance with the auction agency agreements. After receiving the orders from the broker-dealers, the auction agent calculates the clearing rate that will apply until the next auction.

The auction agent allocates the securities to the broker-dealers based on the orders they submitted. The auction procedures generally state that orders are filled in the following order: hold orders, hold-at-rate and buy bids with a rate below the clearing rate, hold-at-rate orders with a rate at the clearing rate, and buy bids with a rate at the clearing rate. When there are more bids for securities at the clearing rate than securities remaining for sale, the securities are allocated on a pro rata basis first to the hold-at-rate bidders and then to the buy bidders.

## 2. Respondents' Conduct

Respondents engaged in the following conduct in connection with certain auctions:

a. Accepting Bids After the Submission Deadline. Auction agency agreements set a formal submission deadline by which broker-dealers had to submit all bids to the auction agent. In certain instances, each Respondent accepted initial and/or revised bids after this submission deadline. In certain instances, this conduct, except when solely done to correct clerical errors, advantaged investors or broker-dealers that bid after a deadline by displacing other investors' bids and affected the clearing rate.<sup>4</sup> This conduct did not conform to disclosed procedures; and

b. Allowing Broker-Dealers To Intervene in Auctions. Each Respondent allowed broker-dealers improperly to intervene in auctions to affect the clearing rate.

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<sup>4</sup> The clearing rate determines the interest rate or yield the issuer must pay to investors until the next auction. In those instances when this practice or any of the practices described in this Order lowered the clearing rate, investors received a lower rate of return on their investments. Conversely, in those instances when the practices raised the clearing rate, issuers had to pay a higher interest rate or yield. To the extent that certain practices affected the clearing rate, investors may not have been aware of the liquidity and credit risks associated with certain securities.

*b.1 Bids To Prevent Failed Auctions.* Failed auctions occur when there are more securities for sale than there are bids for securities and result in an above-market rate described in the disclosure documents. In certain instances, each Respondent informed broker-dealers that auctions might fail without additional bids, allowed bids to be submitted or revised after the auction deadline to prevent failed auctions, and/or thereafter re-ran auctions that otherwise would have been reported as failed auctions. In certain instances, this conduct affected the clearing rate; and

*b.2 Bids To Prevent All-Hold Auctions.* All-hold auctions occur when all current holders want to hold their positions so that there are no securities for sale in the auction and result in a below-market rate described in the disclosure documents. In certain instances, DBTCA and BNY informed broker-dealers that auctions might be all-hold auctions, allowed bids to be submitted or revised after the auction deadline to prevent all-hold auctions, and/or thereafter re-ran auctions that otherwise would have been reported as all-hold auctions. In certain instances, this conduct affected the clearing rate.

#### **D. LEGAL SECTION**

Section 17(a)(2) of the Securities Act prohibits material misstatements and omissions in the offer or sale of securities. Negligent conduct can violate Section 17(a)(2). See, e.g., SEC v. Hughes Capital Corp., 124 F.3d 449, 453 (3d Cir. 1997); In the Matter of Raymond James Financial Services, Inc., Exchange Act Release No. 49234 (Feb. 12, 2004). By engaging in the practices described in Section III.C.2 above, each Respondent caused violations of Section 17(a)(2).

#### **E. STRUCTURE OF THE SETTLEMENT**

In determining the structure of the settlement and the size of the payments that the Respondents undertake to make, the Commission considered the amount of investor harm and the Respondents' conduct in the investigation to be factors that mitigated the serious and widespread nature of the violative conduct. The Commission also considered the Respondents' role and conduct in the auction process relative to the broker-dealers' role and conduct. In addition, the Commission considered the importance of deterring future violations of the securities laws. Finally, the Commission considered the Respondents' respective market share during the relevant period. DBTCA and BNY, which were auction agents for a relatively large share of the auction rate securities market, each will pay \$750,000, and WTC, which was the auction agent for a relatively small share of the auction rate securities market, will pay \$100,000.

#### **F. RESPONDENTS' COOPERATION**

In determining to accept the Offers, the Commission considered the cooperation the Respondents afforded the Commission staff.

## G. UNDERTAKING

DBTCA, BNY, and WTC undertake to pay \$750,000, \$750,000, and \$100,000, respectively, to the United States Treasury within fifteen (15) days of the entry of this Order. This payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the particular Respondent as a Respondent in these proceedings and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Kenneth R. Lench, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street N.E., Washington, DC 20549. By making this payment, Respondent relinquishes all legal and equitable right, title, and interest in such funds, and no part of the funds shall be returned to Respondent. In determining whether to accept the Offers, the Commission has considered this undertaking.

## IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby ORDERED that:

- A. Respondents DBTCA, BNY, and WTC shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act;
- B. Not later than 3 months after the entry of this Order, each Respondent shall provide each broker-dealer that has previously submitted bids for auction rate securities and the issuers of such securities with a written description of the Respondent's material practices and procedures for auctions in which it serves as auction agent. Thereafter, each Respondent shall supply a written description of the Respondent's current material practices and procedures for auctions to broker-dealers and issuers of each offering of auction rate securities for which it serves as auction agent to whom such written description has not previously been provided prior to the issuance of such securities. Whenever such policies and procedures are materially changed, a written statement describing such change shall be provided to each broker-dealer and issuer of auction rate securities for which the Respondent is then serving as auction agent within 60 days of the effective date of such change. A Respondent may fulfill the foregoing requirements to provide such written description by sending it to the dealer's general counsel and to the issuer's senior financial official or to the official of the issuer who executed or will execute the auction agent agreement with such Respondent.

As used in this Section, "auction rate securities" means, with respect to a Respondent, auction rate securities sold in auctions for which Respondent serves as the auction agent; and

- C. Not later than 6 months after the date of this Order, unless otherwise extended by the staff of the Commission for good cause shown, each Respondent's chief executive officer or general counsel shall certify in writing to the staff of the Commission that Respondent has implemented procedures that are reasonably designed to prevent and detect failures by Respondent to conduct the auction process in accordance with the auction procedures described in the disclosure documents and any supplemental disclosures and that the Respondent is in compliance with Section IV.B of this Order.

By the Commission.

Nancy M. Morris  
Secretary

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

Commissioner Atkins  
Not Participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 8768 / January 9, 2007

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55064 / January 9, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12526

In the Matter of

DEUTSCHE BANK TRUST  
COMPANY AMERICAS,  
THE BANK OF NEW YORK,  
and WILMINGTON TRUST  
COMPANY,

Respondents.

ORDER UNDER SECTION 27(A)(b) OF  
THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b) OF THE SECURITIES  
EXCHANGE ACT OF 1934, GRANTING  
WAIVERS OF THE DISQUALIFICATION  
PROVISIONS OF SECTION 27A(b)(1)(A)(ii)  
OF THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b)(1)(A)(ii) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AS TO DEUTSCHE BANK AG AND ITS  
AFFILIATES

I.

Deutsche Bank AG and its subsidiary, Deutsche Bank Trust Company Americas, have submitted a letter, dated November 29, 2006, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from Deutsche Bank Trust Company America's settlement of an administrative proceeding commenced by the Commission. On January 9, 2007, pursuant to the Offer of Settlement by Deutsche Bank Trust Company Americas, the Commission issued an Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 (the "Order"). Under the Order, the Commission found that Deutsche Bank Trust Company Americas caused violations of Section 17(a)(2) of the Securities Act.

The Order requires Deutsche Bank Trust Company Americas (1) to cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act; (2) to make certain disclosures regarding its material auction practices and procedures; and (3) not later than 6 months after the date of this order, unless otherwise extended by the staff of the Commission for good cause shown, have its chief executive officer or general counsel certify in writing to the staff of the Commission that Deutsche Bank Trust Company Americas has implemented procedures that are reasonably designed to prevent and detect failures by Deutsche

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Bank Trust Company Americas to conduct the auction process in accordance with the auction procedures disclosed in the disclosure documents and any supplemental disclosures and that Deutsche Bank Trust Company Americas is in compliance with Section IV.B. of the Order.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of an . . . administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in Deutsche Bank AG and Deutsche Bank Trust Company Americas' letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 27E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Deutsche Bank AG and its affiliates resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
**Assistant Secretary**

*Commissioner Attns  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 8769 / January 9, 2007

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55065 / January 9, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12526

In the Matter of

DEUTSCHE BANK TRUST  
COMPANY AMERICAS,  
THE BANK OF NEW YORK,  
and WILMINGTON TRUST  
COMPANY,

Respondents.

ORDER UNDER SECTION 27(A)(b) OF  
THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b) OF THE SECURITIES  
EXCHANGE ACT OF 1934, GRANTING  
WAIVERS OF THE DISQUALIFICATION  
PROVISIONS OF SECTION 27A(b)(1)(A)(ii)  
OF THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b)(1)(A)(ii) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AS TO THE BANK OF NEW YORK  
COMPANY, INC. AND THE BANK OF  
NEW YORK AND ITS AFFILIATES

I.

The Bank of New York Company, Inc. and its subsidiary, The Bank of New York, have submitted a letter, dated November 13, 2006, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from The Bank of New York's settlement of an administrative proceeding commenced by the Commission. On January 9, 2007, pursuant to the Offer of Settlement by The Bank of New York, the Commission issued an Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 (the "Order"). Under the Order, the Commission found that The Bank of New York caused violations of Section 17(a)(2) of the Securities Act.

The Order requires The Bank of New York (1) to cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act; (2) to make certain disclosures regarding its material auction practices and procedures; and (3) not later than 6 months after the date of this order, unless otherwise extended by the staff of the Commission for good cause shown, have its chief executive officer or general counsel certify in writing to the staff of the Commission that The Bank of New York has implemented procedures

*Document 9 of 54*

that are reasonably designed to prevent and detect failures by The Bank of New York to conduct the auction process in accordance with the auction procedures disclosed in the disclosure documents and any supplemental disclosures and that The Bank of New York is in compliance with Section IV.B. of the Order.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of an . . . administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in The Bank of New York Company, Inc. and The Bank of New York's letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 27E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to The Bank of New York Company, Inc. and The Bank of New York and its affiliates resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

*Commissioner Atkins  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 8770 / January 9, 2007

SECURITIES EXCHANGE ACT OF 1934

Release No. 55066 / January 9, 2007

ADMINISTRATIVE PROCEEDING

File No. 3-12526

In the Matter of

DEUTSCHE BANK TRUST  
COMPANY AMERICAS,  
THE BANK OF NEW YORK,  
and WILMINGTON TRUST  
COMPANY,

Respondents.

ORDER UNDER SECTION 27(A)(b) OF  
THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b) OF THE SECURITIES  
EXCHANGE ACT OF 1934, GRANTING  
WAIVERS OF THE DISQUALIFICATION  
PROVISIONS OF SECTION 27A(b)(1)(A)(ii)  
OF THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b)(1)(A)(ii) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AS TO WILMINGTON TRUST  
CORPORATION AND WILMINGTON  
TRUST COMPANY AND ITS AFFILIATES

I.

Wilmington Trust Corporation and its subsidiary, Wilmington Trust Company, have submitted a letter, dated November 22, 2006, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from Wilmington Trust Company's settlement of an administrative proceeding commenced by the Commission. On January 9, 2007, pursuant to the Offer of Settlement by Wilmington Trust Company, the Commission issued an Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 (the "Order"). Under the Order, the Commission found that Wilmington Trust Company caused violations of Section 17(a)(2) of the Securities Act.

The Order requires Wilmington Trust Company (1) to cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act; (2) to make certain disclosures regarding its material auction practices and procedures; and (3) not later than 6 months after the date of this order, unless otherwise extended by the staff of the Commission for good cause shown, have its chief executive officer or general counsel certify in writing to the staff of the Commission that Wilmington Trust Company has implemented

*Document 10 of 54*

procedures that are reasonably designed to prevent and detect failures by Wilmington Trust Company to conduct the auction process in accordance with the auction procedures disclosed in the disclosure documents and any supplemental disclosures and that Wilmington Trust Company is in compliance with Section IV.B. of the Order.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of an . . . administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in Wilmington Trust Corporation and Wilmington Trust Company's letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 27E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Wilmington Trust Corporation and Wilmington Trust Company and its affiliates resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris  
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. 2578 / January 9, 2007**

**Administrative Proceeding**  
**File No. 3-12527**

**In the Matter of**

**LAWRENCE J. LASSER,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS  
AND A CEASE-AND-DESIST ORDER  
PURSUANT TO SECTIONS 203(f)  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940**

**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 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Lawrence J. Lasser ("Respondent" or "Lasser").

**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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

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### III.

On the basis of this Order and Lasser's Offer, the Commission finds<sup>1</sup> that:

#### **Respondent**

1. Lawrence J. Lasser, age 63, is a resident of Brookline, Massachusetts. Lasser began working for Putnam Management Company, which later changed its name to Putnam LLC, in 1969, and served in various senior positions until his employment officially ended on December 31, 2003. Lasser served as the President of Putnam Investment Management, LLC from 1982 until approximately November 1, 2003 and was the Chief Executive Officer of Putnam LLC from 1985 until approximately November 1, 2003. Lasser also served as a trustee of the Putnam Funds from approximately 1992 through 2003. In his position as CEO, the operating heads of the Putnam LLC subsidiaries, including Putnam Investment Management, LLC, the Putnam Funds' investment adviser, and Putnam Retail Management Limited Partnership, the Putnam Funds' distributor, reported to him. Lasser is currently retired.

#### **Other Related Entities**

2. Putnam Investment Management, LLC ("Putnam") is the registered investment adviser to the over 100 registered investment companies in the Putnam Fund Complex, which include retail mutual funds, registered closed-end funds and open-end mutual funds that underlie variable annuities ("Putnam Funds"). Since 1971, Putnam has been registered with the Commission pursuant to Section 203(c) of the Advisers Act. Putnam is owned by Putnam Investment Management Trust, a wholly-owned subsidiary of Putnam LLC, a Delaware limited liability company that conducts business as Putnam Investments. The operating head of Putnam reported to Lasser from at least January 1, 2000 to November 1, 2003. Putnam's principal offices are located in Boston, Massachusetts.

3. Putnam Retail Management Limited Partnership ("PRM") is the distributor of the Putnam Funds and a subsidiary of Putnam LLC. Since 2000, PRM has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934. The operating head of PRM reported to Lasser from at least January 1, 2000 to November 1, 2003. PRM's principal offices are located in Boston, Massachusetts.

4. Putnam LLC ("Putnam Investments") is a Delaware limited liability company that conducts business as Putnam Investments. Putnam Investments is owned by Putnam Investments Trust, a Massachusetts business trust. Putnam Investments Trust is a subsidiary of Marsh & McLennan Companies, Inc., which is a publicly-owned

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<sup>1</sup> 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.

holding company traded on the New York Stock Exchange, whose operating subsidiaries are international insurance brokers, investment managers and management consultants. Putnam Investments is the parent of PRM, and Putnam Investment Management Trust, which is the parent of Putnam. The financial statements of the subsidiaries, including PRM and Putnam, were included in consolidated financial statements of Putnam Investment Trust, Putnam Investments' parent. Putnam, PRM and Putnam Investments shared administrative, financial and legal services and functioned as a single corporation. These divisions are collectively referred to as "the Putnam organization." Putnam Investments' principal offices are located in Boston, Massachusetts.

### Overview

5. From at least January 1, 2000 through November 1, 2003 (the "relevant time period"), Lasser was the CEO of Putnam Investments and the President of Putnam, and a member of the Putnam Funds' Board of Trustees (the "Putnam Board" or "Trustees"). During the relevant time period, Lasser was responsible for ensuring that Putnam fulfilled its fiduciary duty to disclose adequately to the Putnam Board the use of fund brokerage commissions and potential conflicts of interest created by the use of fund brokerage commissions.

6. During the relevant time period, Putnam, the Putnam Funds' investment adviser, directed brokerage commissions on the Putnam Funds' portfolio transactions to broker-dealers for "shelf space" or heightened visibility within their distribution systems.<sup>2</sup> PRM, the Putnam Funds' distributor and an affiliate of Putnam, had entered into arrangements ("Preferred Marketing Arrangements") with over 80 broker-dealers whereby the broker-dealers provided services designed to promote the sale of the Putnam Funds. Approximately 20 of those broker-dealers were paid in cash, while over 60 broker-dealers received directed brokerage commissions from the Putnam Funds' portfolio transactions. All of these arrangements were based primarily upon negotiated formulas relating to gross or net fund sales and/or the retention of fund assets.

7. When Putnam directed fund brokerage commissions to broker-dealers in connection with the Preferred Marketing Arrangements, its affiliate, PRM, did not use its own assets to pay for the services obtained under these arrangements. As a result, because the financial statements of these entities were included in consolidated financial statements of Putnam Investments Trust, the parent of Putnam Investments, the entire Putnam organization benefited from the use of Putnam Funds' assets to defray such expenses. However, Putnam did not adequately disclose this potential conflict of interest to the Putnam Board. Putnam also did not adequately disclose to the Trustees the potential conflict of interest presented for its Equity Trading group, which was faced with directing trades to specific broker-dealers designated by PRM in connection with Preferred Marketing Arrangements while at the same time satisfying its best execution obligations. Nor did Putnam adequately disclose to the Trustees the specific terms and

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<sup>2</sup> On March 23, 2005, the Commission instituted settled public administrative and cease-and-desist proceedings against Putnam Investment Management, LLC. See In the Matter of Putnam Investment Management, LLC, Investment Advisers Act Rel. No. 2370 (March 23, 2005).

details of the Preferred Marketing Arrangements that were being paid for with brokerage commissions, including the fact that PRM, its affiliate, had arrangements with broker-dealers to direct fund brokerage commissions for marketing and distribution services pursuant to negotiated formulas with the broker-dealers.

8. Lasser knew that Putnam used fund brokerage commissions to satisfy the Preferred Marketing Arrangements and he was aware of potential conflicts of interest created by this use. Lasser, however, did not, himself, adequately disclose to the Trustees the use of brokerage commissions or potential conflicts of interest created by this use. Lasser also did not ensure that anyone else at Putnam adequately disclosed this information to the Trustees.

#### **PRM Had Preferred Marketing Arrangements with Broker-Dealers**

9. Since at least January 2000 through December 2003, PRM had over 80 relationships with certain broker-dealers pursuant to which the Putnam Funds received heightened visibility within the broker-dealers' distribution or sales systems. The Putnam Funds' distributor, PRM, negotiated the Preferred Marketing Arrangements on behalf of itself and Putnam, the Putnam Funds' investment adviser. At all times, PRM entered into these arrangements with the knowledge and approval of Putnam and Putnam Investments.

10. The broker-dealers provided various types of distribution services in connection with these arrangements: participation in meetings with registered representatives, primarily for the purpose of providing education and training regarding the Putnam Funds; the opportunity for the Putnam Funds to be mentioned in communications with a broker-dealer's customers such as on a broker-dealer's website; and often, placement on a "preferred list" at a broker-dealer.

11. Various financial terms existed for participation in the broker-dealers' Preferred Marketing programs based upon the formulas that PRM had individually negotiated. Typically, broker-dealers were paid anywhere from 10 to 35 basis points ("bps") on mutual fund gross or net sales and/or 1.5 to 15 bps on aged assets. These payments were in addition to existing payments, including dealer concessions, shareholder servicing payments, and payments for services that Putnam or an affiliate otherwise would provide.

#### **Putnam Directed Brokerage Commissions to Pay for Preferred Marketing Arrangements**

12. Although many broker-dealers sought Preferred Marketing payments in the form of cash or "hard dollars," PRM generally negotiated to direct brokerage commissions on the Putnam Funds' portfolio transactions. Putnam and PRM referred to these directed fund brokerage commissions as "soft dollars," "fund sales," or "commissions for sales." In the ordinary course, to conduct portfolio transactions in connection with the Putnam Funds' investment program, the Funds pay substantial amounts in brokerage commissions for execution services. In addition to the execution

services, Putnam and its affiliates at times also received soft dollar and other benefits from such commissions, including research and the payment of fund custody expenses. During the relevant period, Putnam directed some commissions to broker-dealers to pay for Preferred Marketing Arrangements.

13. Although PRM or Putnam Investments in some instances used its own cash, Putnam, PRM, and Putnam Investments preferred to direct fund brokerage commissions to pay for these arrangements. Putnam's use of brokerage commissions directly benefited Putnam Investments and PRM by reducing their out-of-pocket expenses. It was also in Putnam's financial interest to defray the expenses of an affiliate because of the positive impact on the Putnam organization's operating income. This preference was reflected in an internal presentation PRM created on revenue sharing that stated that PRM was "always pushing toward a soft dollar deal" when negotiating these arrangements. The impact of this preference was that PRM had substantially more Preferred Marketing Arrangements in soft dollars than in hard dollars.

14. From at least January 1, 2000 through December 31, 2003, Putnam directed fund brokerage commissions to over 60 broker-dealers for the Preferred Marketing Arrangements.<sup>3</sup> When PRM negotiated to direct brokerage commissions to pay for these arrangements, it sometimes negotiated to direct brokerage commissions of 1.5 times (or some other negotiated multiple or conversion rate) the amounts requested by the broker-dealers in hard dollars.

15. In order for Putnam to properly direct fund brokerage commissions for the arrangements, PRM communicated the commission amounts, but not the details of the basis point arrangements, for each of the broker-dealers to the Head of Putnam's Equity Trading ("Equity Trading"). These amounts, referred to as commission targets ("targets"), were primarily based upon the formulas negotiated with the broker-dealers. Equity Trading used the targets, subject to its own guidelines, including the requirement for the traders to seek best execution, to direct fund brokerage commissions to the broker-dealers.

16. Periodically, PRM communicated modified commission target amounts for individual brokers to Equity Trading based upon the priorities PRM set for these broker-dealers. These modifications for individual brokers were sometimes increases and sometimes decreases to the targets. At times, PRM requested that Equity Trading increase trading with specific broker-dealers in order to more quickly meet target commission amounts with broker-dealers and provided suggested priority status among the various broker-dealers. Equity Trading accepted the modifications, subject to Putnam's best execution policies.

17. The management of Equity Trading periodically circulated to the traders a list prepared by PRM reflecting the directed brokerage target amounts for each broker-

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<sup>3</sup> Based upon the Putnam Board's direction, Putnam ceased directing brokerage to broker-dealers in connection with the sale of fund shares as of January 1, 2004.

dealer, commission amounts paid to each broker-dealer during that year, the current balance of the target remaining, and the percentage of completion toward the target. Thus, Putnam's traders were made aware of the targets and placed trades with the fund-selling broker-dealers subject to the firm's best execution policies. In addition to the fund sales targets, the traders were also made aware of other brokerage commission targets, including those for research.

18. Putnam had a computerized system that categorized trades based upon the percentage of completion of the target. Six such categories existed, including research, proprietary research, fund sales, custody, execution and client-directed. For example, if Putnam placed a trade with a broker-dealer that had both fund sales and research targets, the computer would automatically assign the brokerage commission to the category for which the target was farthest away from completion. If a trade or a certain portion of a trade was assigned to fund sales, the associated commission was used to pay for a Preferred Marketing arrangement. In addition to assigning the trades on Putnam's internal records, Putnam's trading system also electronically communicated this information to the trading desks at the broker-dealers that executed the trades.

19. Putnam used two methods to direct brokerage commissions for Preferred Marketing Arrangements: by forwarding portfolio transactions directly to a broker-dealer with which it had such an arrangement ("distributing broker"); and through "step-out" or correspondent arrangements. Putnam used the latter method in its effort to achieve best execution in circumstances in which the distributing broker's execution capability did not satisfy Putnam's trading department's standards.

#### **Putnam Used Brokerage Commissions to Satisfy Preferred Marketing Arrangements**

20. Putnam had a policy relating to placing portfolio transactions with broker-dealers who sold Putnam Funds in recognition of their sales of Putnam Funds' shares. Its policy was that, consistent with NASD Rule 2830(k), Putnam may consider sales of shares of Putnam Funds as a factor in the selection of broker-dealers to execute portfolio transactions for the Putnam Funds ("2830(k) transactions").

21. Within Putnam, guidance was given that agreements for the allocation of brokerage commissions could not be made. Also, PRM's internal policy was that amounts directed to broker-dealers in consideration of fund sales were not obligations and therefore, directed brokerage arrangements should not be put into writing.

22. Lasser knew that Putnam used brokerage commissions to satisfy the Preferred Marketing Arrangements. Lasser understood that there was a difference between 2830(k) transactions and Putnam's practice of directing commissions to pay for Preferred Marketing Arrangements with broker-dealers. Lasser also knew that PRM and Putnam preferred to pay for the Preferred Marketing Arrangements with commissions, rather than having PRM pay for them in cash, because using commissions allowed PRM to avoid using its own assets to pay for these arrangements.

**Putnam's Directed Brokerage Practices  
Were Not Adequately Disclosed to the Trustees**

23. During the relevant time period, the Trustees received periodic reports listing all brokerage firms and the commissions they received pursuant to 2830(k) transactions. In addition, when Putnam made presentations to the Putnam Board, Putnam conveyed to the Trustees that Putnam's stated internal policies were that agreements for the allocation of commissions could not be made and repeatedly assured the Putnam Board that there were no agreements for commissions used for 2830(k) transactions, that only targets were set and no firm amounts of commissions were promised to broker-dealers. Putnam did not adequately disclose to the Putnam Board that it was directing fund brokerage commissions to over 60 broker-dealers to pay for PRM's Preferred Marketing Arrangements. While Putnam communicated generally to the Trustees that broker-dealers were seeking financial support, Putnam did not adequately disclose to the Trustees the existence of the arrangements with the broker-dealers, the terms or details of the arrangements, or the preference to direct brokerage commissions, which were fund assets, rather than using PRM's or Putnam Investments' assets.

24. During the relevant time period, when Putnam provided the Board with information relevant to the annual review and approval of the management contract for the Putnam Funds, Putnam also provided a memorandum to the Board describing "fall-out benefits" received by both Putnam and its affiliates. Among other things, the memorandum identified that Putnam conducted trading for the Putnam Funds, and in connection with that trading, Putnam received research related services from broker-dealers in consideration of those commissions. While the memorandum reiterated the policy that Putnam may engage in 2830(k) transactions, it did not discuss the Preferred Marketing Arrangements nor did it identify the distribution services received with the Funds' brokerage commissions.

25. During the relevant time period, Lasser was responsible for ensuring that the Trustees were adequately informed on the use of brokerage commissions. Lasser, as the head of the Putnam organization and as a Trustee, attended the monthly Putnam Board meetings and made presentations to the Trustees. During these meetings, Lasser reported on the state of the business and could discuss any issue he believed to be important. Lasser also made yearly presentations during the Executive Session of the Contract Committee in which he would address issues raised by the Contract Committee. Lasser knew Putnam used brokerage commissions to satisfy the Preferred Marketing Arrangements and that he and PRM preferred to use brokerage commissions to pay for these arrangements. However, Lasser did not adequately disclose this information to the Trustees and he did not ensure that anyone else disclosed this information to the Trustees.

**Potential Conflicts of Interest Were Not Adequately Disclosed to the Trustees**

26. As a fiduciary, Putnam had a duty to disclose adequately to the Putnam Board potential conflicts of interest created by the use of fund brokerage commissions,

yet it failed to do so. Lasser, as the head of the Putnam organization and as a Trustee of the Putnam Funds, was responsible for ensuring that Putnam fulfilled this duty.

27. The use of brokerage commissions to pay for participation in Preferred Marketing Arrangements created two potential conflicts of interest for Putnam. The first related to the use of fund assets to satisfy what would otherwise have been obligations of PRM. Because PRM and Putnam were under common control, Putnam benefited from the use of fund assets to defray the expenses of its affiliate, PRM.

28. The second potential conflict was the one that Putnam's Equity Trading group faced while trying both to satisfy its best execution obligations and to direct trades to specific broker-dealers identified by PRM. Specifically, Equity Trading had to determine: which broker-dealers to place trades with and what commission rates to pay; whether to use single stock trades or program trading; whether to reduce the number of broker-dealers with which Putnam traded; and whether these relationships affected the transaction costs of the directed trades and Equity Trading's objectives to reduce overall transaction costs.

29. Due to his role as the head of the Putnam organization, Lasser knew of potential conflicts of interest created by the use of fund brokerage commissions. However, despite his numerous presentations to the Putnam Board, Lasser did not adequately disclose to the Trustees potential conflicts of interest that arose from Putnam's use of brokerage commissions and failed to ensure that anyone else adequately disclosed this information.

30. In August 2003, Lasser received a copy of a memorandum prepared by Putnam's Investment Division, which included Equity Trading. The memorandum recommended, among other things, eliminating the use of brokerage commissions for 2830(k) transactions, which would have the effect of eliminating the use of brokerage commissions for the Preferred Marketing Arrangements. Lasser knew as early as April 2003 that the Trustees were also considering eliminating 2830(k) transactions. Lasser knew in June 2003 that the Putnam Board's Contract Committee would be making a recommendation to the full Board on this issue at the September 2003 Board meeting. Lasser did not provide this memorandum to the Trustees.

31. Lasser also heard from certain managers in Putnam's Investment Division that they believed Putnam should eliminate 2830(k) transactions. Approximately one week before the September 2003 Putnam Board meeting, Lasser asked certain managers in Putnam's Investment Division to allow him to represent Putnam on the issue of 2830(k) transactions until the Trustees had made their decision. He also asked that if the managers were participating in any meetings with the Trustees, they should defer any questions and views regarding 2830(k) transactions to him.

32. At or about this time, Lasser was attempting to persuade certain Trustees to not eliminate 2830(k) transactions. In September 2003, Lasser addressed the Contract Committee on this issue. In his presentation, Lasser did not adequately disclose to the

Trustees all aspects of the use of brokerage commissions and the attendant conflicts of interests. Lasser attempted to persuade the Contract Committee not to recommend to the full Board that Putnam eliminate 2830(k) transactions.

33. As a result of the conduct described above, Lasser willfully aided and abetted and was a cause of Putnam's violation of Section 206(2) of the Advisers Act, which provides that it is "unlawful for an investment adviser, by the use of the mails or any means or instrumentality of interstate commerce, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

#### IV.

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

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Lasser shall cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act;

B. Respondent Lasser shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$75,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Lawrence J. Lasser as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, District Administrator, Philadelphia District Office, U.S. Securities and Exchange Commission, Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106.

By the Commission.

Nancy M. Morris  
Secretary

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

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**January 10, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12530**

**In the Matter of**

**Providence Capital III, Inc.,  
Providence Capital IV, Inc.,  
Providence Capital VI, Inc.,  
Providence Capital VII, Inc., and  
Providence Capital X, 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").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Providence Capital III, Inc. (CIK No. 1110048) is a dissolved Colorado corporation located in Chattanooga, Tennessee with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Providence Capital III, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic report since it filed a Form 10-QSB for the period ended March 31, 2002. The President, Vice President and Secretary of the company serve in the same respective capacities with all of the co-respondents.

2. Providence Capital IV, Inc. (CIK No. 1110047) is a dissolved Colorado corporation located in Chattanooga, Tennessee with a class of equity securities registered

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with the Commission pursuant to Exchange Act Section 12(g). Providence Capital IV, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic report since it filed a Form 10-QSB for the period ended March 31, 2002. The President, Vice President and Secretary of the company serve in the same respective capacities with all of the co-respondents.

3. Providence Capital VI, Inc. (CIK No. 1110043) is a dissolved Colorado corporation located in Chattanooga, Tennessee with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Providence Capital VI, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic report since it filed a Form 10-QSB for the period ended March 31, 2002. The President, Vice President and Secretary of the company serve in the same respective capacities with all of the co-respondents.

4. Providence Capital VII, Inc. (CIK No. 1110726) is a dissolved Colorado corporation located in Chattanooga, Tennessee with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Providence Capital VII, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic report since it filed a Form 10-QSB for the period ended March 31, 2002. The President, Vice President and Secretary of the company serve in the same respective capacities with all of the co-respondents.

5. Providence Capital X, Inc. (CIK No. 1110018) is a dissolved Colorado corporation located in Chattanooga, Tennessee with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Providence Capital X, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2002. The President, Vice President and Secretary of the company serve in the same respective capacities with all of the co-respondents.

#### B. DELINQUENT PERIODIC FILINGS

6. The Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), 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 at their most recent address shown in their most recent filing with the Commission.

7. 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 (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

8. As a result of their failure to file required periodic filings, Respondents 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 of this Order are true, and 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 to revoke the registrations of each class of securities registered pursuant to Exchange Act Section 12 of the Respondents identified in Section II.

### 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 each 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 a 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 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 each Respondent personally, by certified or registered mail, or by any other means permitted by the Commission's 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.

Nancy M. Morris  
Secretary

Attachment

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

**Appendix 1**

**Chart of Delinquent Filings**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Providence Capital III, Inc.</b>	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent		18			

**Providence Capital IV, Inc.**

10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Providence Capital IV, Inc.</b>					
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 18

**Providence Capital VI, Inc.**

10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7
10-QSB	06/30/06	08/14/06	Not filed	4
10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 18

**Providence Capital VII, Inc.**

10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
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**Providence Capital VII, Inc.**

10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7
10-QSB	06/30/06	08/14/06	Not filed	4
10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 18

**Providence Capital X, Inc.**

10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7
10-QSB	06/30/06	08/14/06	Not filed	4

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Providence Capital X, Inc.</b>	<i>10-QSB</i>	09/30/06	11/14/06	Not filed	1
<b>Total Filings Delinquent</b>	<b>18</b>				

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55077 / January 10, 2007

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 2538 / January 10, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-11374

In the Matter of  Stuart A. Nussbaum, CPA	: : : : : : :	ORDER GRANTING APPLICATION FOR REINSTATEMENT TO APPEAR AND PRACTICE BEFORE THE COMMISSION AS AN ACCOUNTANT
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On January 15, 2004, Stuart A. Nussbaum ("Nussbaum") was suspended from appearing or practicing as an accountant before the Commission as a result of settled public administrative proceedings instituted by the Commission against Nussbaum pursuant to Rule 102(e) of the Commission's Rules of Practice.<sup>1</sup> Nussbaum consented to the entry of the January 15, 2004 order without admitting or denying the findings therein. This order is issued in response to Nussbaum's application for reinstatement to practice before the Commission as an accountant.

During the years 1997 and 1998, Nussbaum was employed as a senior manager at Weiser LLP ("Weiser"). During these two years, Nussbaum participated as the manager on Weiser's surprise inspections of the Sagam Capital Management Corporation ("Sagam Corp."). As the manager of these surprise inspections, the Commission alleged that Nussbaum engaged in instances of highly unreasonable conduct by failing to conduct them in accordance with the Investment Advisers Act of 1940 ("Advisers Act") Rule 206(4)-2(a)(5). This conduct caused and aided and abetted Sagam Corp.'s violations of Section 206(4) of the Advisers Act and constituted improper professional conduct.

Nussbaum has met all of the conditions set forth in his suspension 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

<sup>1</sup> See Accounting and Auditing Enforcement Release No. 1943 dated January 15, 2004. Nussbaum was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

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, Nussbaum 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.

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."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of the information supplied, representations made, and undertakings agreed to by Nussbaum, it appears that he has complied with the terms of the January 15, 2004 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 Nussbaum, 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 Nussbaum, 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,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Stuart A. Nussbaum, CPA is hereby reinstated to appear and practice before the Commission as an accountant.

By the Commission.

Nancy M. Morris  
Secretary

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

<sup>2</sup> 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).

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 55074 / January 10, 2007**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-12528**

**In the Matter of**

**ABLE LABORATORIES, INC.**

**Respondent.**

**ORDER INSTITUTING PROCEEDINGS, MAKING  
FINDINGS, AND REVOKING REGISTRATION OF  
SECURITIES 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 proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Able Laboratories, Inc. ("Able" 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, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) 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:

A. Able (CIK #857171), headquartered in Montclair, New Jersey, is a former developer and manufacturer of generic pharmaceutical products. Able initially registered its common stock with the Securities and Exchange Commission in September 1992 pursuant to

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Section 12(b) of the Exchange Act. In November 2003, the Commission granted Able's application to withdraw from listing and registration on the Boston Stock Exchange and, from that point forward, Able was deemed registered pursuant to Section 12(g) of the Exchange Act.

Until November 2002, Able's stock was traded under the symbol "ABRX" on the OTC Bulletin Board. Able traded on the Nasdaq SmallCap Market from November 2002 until February 2003, and on the Nasdaq National Market System from February 2003 until July 2005. The company's common stock subsequently traded on the OTC Bulletin Board until August 2006. Able is not currently quoted by any market makers.

B. Able has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder in that, while its common stock has been registered with the Commission at all relevant times, it has not filed an Annual Report on Form 10-K since March 15, 2005 or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending March 31, 2005.

#### 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.

Nancy M. Morris  
Secretary

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

## SECURITIES AND EXCHANGE COMMISSION

[Release No. PA-38; File No. S7-02-07]

**Privacy Act of 1974:** Notice of Alteration to two existing Systems of Records.

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice of proposed alteration to two existing systems of records.

**SUMMARY:** In accordance with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a, the Securities and Exchange Commission proposes to alter the Privacy Act system of records: "Personnel Management Employment and Staffing Files (SEC-39)", which was previously identified in the Federal Register at 41 FR 41591 on September 22, 1976, 50 FR 37750 on September 17, 1985 and 62 FR 47884 on September 11, 1997.

Also, the Commission is proposing to make changes to its system of records "Identification and Access Control Cards, Special Credentials, Press Passes, and Building Access Control Cards (SEC-46)", originally published at 63 FR 37423, July 10, 1998.

**DATES:** Effective Date: The changes will become effective [Insert date 40 days after publication in the Federal Register] unless further notice is given. The Commission will publish a new notice if the effective date is delayed to review comments or if changes are made based on comments received.

Comment Date: To be assured of consideration, comments should be received on or before [Insert date 30 days after publication in the Federal Register].

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

Electronic Comments:

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- Use the Commission's Internet comment form  
(<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-02-07 on the subject line.

**Paper Comments:**

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-02-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site

(<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Barbara A. Stance, Chief Privacy Officer, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Mail Stop 0-7, Alexandria, VA 22312-2413, (202) 551-7209.

**SUPPLEMENTARY INFORMATION:** The Commission proposes to alter the system of records, "Personnel Management Employment and Staffing Files (SEC-39)." As described in the original notice, the system contains information on applicants for SEC employment, and present and past employees. This notice is published to alter the system

organizational directories or similar records for internal management purposes, and (2) to Commission contractors or their authorized employees, and other Federal agencies for the purpose of assisting the Commission in the efficient administration of its programs; by changing the name of the system manager to the Office of Human Resources; and by changing the address for submitting requests for record notification, access and contesting to the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

The Commission also proposes to alter the system of records, "Identification and Access Control Cards, Special Credentials, Press Passes, and Building Access Control Cards (SEC-46)." As described in the original notice, the system is designed to permit access to Commission facilities by Commission employees, members of the press, contractors and consultants. This notice is published to modify the system of records by changing the system name from Identification Cards, Press Passes and Proximity Access Control Cards to Identification and Access Control Cards, Special Credentials, Press Passes, and Building Access Control Cards; by changing the system location from the Office of Administrative and Personnel Management to the Office of Administrative Services; by adding three new routine uses, (1) to disclose information to other Federal agencies to verify the identity and status of the PIV Card holder, (2) to Commission contractors or their authorized employees, and other Federal agencies for the purpose of assisting the Commission in the efficient administration of its programs, and (3) in connection with organizational directories or similar records for internal management purposes; by changing the system manager and address to the Office of Administrative Services, Security Branch, Securities and Exchange Commission, 100 F Street NE,

Washington, DC 20549-1627; by changing the address for submitting requests for record notification, access and contesting to the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100; and by expanding the record source categories to include volunteers, on-site business owners or clients, employees of other Federal agency and visitors. This notice is also altered to incorporate requirements of Homeland Security Presidential Directive 12 (HSPD-12) by expanding the categories and individuals covered by the system to include volunteers, tenants and employees of other Federal agencies; by clarifying and expanding the categories of records in the system, adding a note explaining that, to the extent that the Commission has records of a personnel investigative nature that come from the Office of Personnel Management or its contractors, they are covered by OPM/CENTRAL-9, Personnel Investigative Records, and not this system notice; and by expanding the authority for maintenance of the system and the purpose statement to include reference to HSPD-12.

The Commission has submitted a report of the altered systems of records to the Senate Committee on Homeland Security and Governmental Affairs, the House Committee on Government Reform, and the Office of Management and Budget, pursuant to 5 U.S.C. 552a(r) of the Privacy Act of 1974, as amended, and Appendix I to OMB Circular A-130, "Federal Agency Responsibilities for Maintaining Records About Individuals," as amended on February 20, 1996 (61 FR 6435).

Accordingly, the Commission is altering the systems of records to read as follows:

**SEC-39**

**SYSTEM NAME:** Personnel Management Employment and Staffing Files.

**SYSTEM LOCATION:** Securities and Exchange Commission, Operations Center, 6432 General Green Way, Mail Stop 0-1, Alexandria, VA 22312-2413.

**CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:**

Records are maintained on applicants for SEC employment and present and past employees.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

The system of records includes the following category of records:

- (a) Applicant files (Computerized applications, Standard Forms 171 and resumes, attorney supplements to applications, applicant correspondence and evaluations, and summer employment files);
- (b) Official personnel folders (Office of Human Resources files);
- (c) Service record cards;
- (d) Merit promotion posting files, including supervisory appraisals for jobs advertised under SEC Merit Promotion Program;
- (e) Request to Office of Personnel Management for Schedule C personnel actions;
- (f) Chronological copies of personnel actions (Standard Forms 50);
- (g) Office of Personnel Management clerk-typist and clerk-steno examination papers for applicants tested under SEC's delegated recruiting authority;
- (h) Division/Office/Region employee record cards or electronic media; and
- (i) Regional Office employee files, including copies of applications and notifications of personnel action (Standard Forms 50) on the employee concerned.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

5 CFR, parts 213, 293, 302, and 335; 5 U.S.C. 3109 and Civil Service Regulations promulgated thereunder.

**ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:**

These records and the information contained in these records may be used or disclosed as follows:

1. Records in category (a) above are used by SEC staff to make referrals to supervisors or administrative assistants in offices with vacancies for which applicants may be considered. Offices may retain copies of applications/resumes and evaluations of candidates they interview whom they feel may be contenders for employment offers later in the year.
2. SEC staff uses records in category (b) above for (i) retention of official personnel documents; (ii) verification of employment; (iii) determination of qualifications for jobs and eligibility for training; and (iv) processing of personnel actions.
3. SEC staff uses records in category (c) above for (i) computation of personnel strength of divisions/offices; (ii) verification of employment for credit checks or job applications; and (iii) recording of personnel actions processed.
4. SEC staff uses records in category (d) above to maintain records required by the Office of Personnel Management of competitive promotion actions, including (i) records to determine how an announcement for a particular job reads; (ii) records for statistical reports; and (iii) records for program effectiveness studies (to send questionnaires to supervisors who made selections under the program, for example).

Supervisory appraisals are scored and used in determining employee's overall standing among all applicants for the job; they are sent to selecting supervisors for review if the employee is certified for consideration (interview).

5. SEC staff uses records in category (e) above to identify Office of Personnel Management control numbers for Schedule C positions and to aid in preparing new submissions.
6. SEC staff uses records in category (f) above for statistical reports.
7. SEC staff forwards records in category (g) above to the Office of Personnel Management at the end of each month if the applicant is not hired; if applicant is hired, records are retained for one year and then destroyed.
8. SEC staff uses records in category (h) above to monitor personnel actions concerning their staffs (i.e., date of employee's last promotion, employee's position description number, etc.) and to record date personnel action requests and reports were forwarded to the Office of Personnel.
9. SEC Regional Offices use records in category (i) above as a reference in preparing personnel actions requests on employees, determining employee eligibility for training or career development counseling and for back-up data in preparing award nominations, etc.
10. Any of the records described above may be used by the Commission in connection with any action or proceeding brought by an employee before another agency or a court of law to review personnel action taken by the Commission or the failure by the Commission to take action.

11. In any proceeding where the Federal securities laws are in issue or in which the Commission or past or present members of its staff is a party or otherwise involved in an official capacity.
12. To a Federal, State or local governmental authority maintaining civil, criminal or other relevant enforcement information or other pertinent information, such as current licenses, if necessary to obtain information relevant to an agency decision concerning the hiring or retention of an employee, the issuance of a security clearance, the letting of a contract, or the issuance of a license, grant or other benefit.
13. To a Federal, State or local governmental authority, in response to its request, in connection with the hiring or retention of an employee, the issuance of a security clearance, the reporting of an investigation of an employee, the letting of a contract, or the issuance of a license, grant, or other benefit by the requesting agency, to the extent that the information is relevant and necessary to the requesting agency's decision on the matter.
14. As a data source for management information for production of summary descriptive statistics and analytical studies in support of the function for which the records are collected and maintained or for related personnel management functions or manpower studies; may also be utilized to respond to general requests for statistical information (without personal identification of individuals) under the Freedom of Information Act or to locate specific individuals for personnel research or other personnel management functions.

15. To aid in responding to inquiries from an employee, Member of Congress, the press or others concerning personnel action taken with respect to a specified employee or employees.
16. Records in this system may, at the discretion of the Commission's staff, be disclosed to any person during the course of any inquiry or investigation conducted by the Commission staff, or in connection with civil litigation, if the staff has reason to believe that the person to whom the record is disclosed may have further information about the matters related therein, and those matters appeared to be relevant at the time to the subject matter of inquiry.
17. To a congressional office from the record of an individual in response to an inquiry from the congressional office made at the request of that individual.
18. To the Office of Management and Budget in connection with the review of private relief legislation as set forth in OMB Circular A-19 at any stage of the legislative coordination and clearance process as set forth in that circular.
19. To Commission contractors or their authorized employees, and other Federal agencies, as necessary, for the purpose of assisting the Commission in the efficient administration of its programs. These contractors will be required to maintain Privacy Act safeguards with respect to such records.
20. The information contained in this system may be used by the Commission in connection with organizational directories or similar records for internal management purposes.

**POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:**

**STORAGE:** Records are maintained in electronic or paper form.

**RETRIEVABILITY:** Records are indexed by name.

**SAFEGUARDS:** Records in categories (a)-(g) are pulled and re-filed by Office of Human Resources staff only and that Office is locked each evening. Access to official Personnel Folders is limited to employee concerned, his/her supervisors and administrative assistant, supervisors/administrative assistants considering him/her for a job or employee's designated representative; access by other individuals on official business is on a need-to-know basis as approved by the Associate Executive Director, Office of Human Resources. Personnel folders are locked in the Diebold file each evening. Division/Office Directors and Regional Directors are responsible for keeping employee record cards, electronic media or employee files (Regional Offices only) under lock and for assuring confidentiality. The national office in Washington, DC has a 24-hour security guard.

**RETENTION AND DISPOSAL:**

Records in category (a) are retained six months and then destroyed. Records in category (b) are forwarded to Federal Records Center 30 days after the employee leaves the SEC by retirement, resignation or death or forwarded to agency to which employee transfers as soon as new agency requests them. Records in category (c) are retained indefinitely. Records in category (d) are retained two years and then destroyed. Records in category (e) are retained indefinitely. Records in category (f) are retained five years and then destroyed. Records in category (g) are sent to the Office of Personnel Management at the end of the month if the applicant is hired. If the applicant is not hired, records are retained one year and then destroyed. Records in category (h) are retained indefinitely. Records in

category (i) are retained while employee is assigned to office and forwarded to new SEC office if he/she transfers or destroyed if employee leaves the SEC.

**SYSTEM MANAGER(S) AND ADDRESS:**

Associate Executive Director, Office of Human Resources, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Mail Stop 0-1, Alexandria, VA 22312-2413.

**NOTIFICATION PROCEDURE:**

All requests to determine whether this system of records contains a record pertaining to the requesting individual may be directed to the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20579-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

**RECORD SOURCE CATEGORIES:**

Records in category (a) are obtained from applicant concerned and interviewer evaluating the applicant. Records in category (b) are obtained from employee and supervisors concerned. Records in category (c) are obtained from official personnel folder of the employee concerned. Records in category (d) are obtained from employees applying for job and their supervisors. Records in category (e) are obtained from employees and supervisors concerned. Records in category (f) are obtained from employees and

supervisors concerned. Records in category (g) are obtained from applicant. Records in category (h) are obtained from official personnel actions, employees and supervisors concerned. Records in category (i) are obtained from official personnel actions, employees and supervisors concerned.

**EXEMPTIONS CLAIMED FOR THIS SYSTEM:**

None

**SEC-46**

**SYSTEM NAME:** Identification and Access Control Cards, Special Credentials, Press Passes, and Building Access Control Cards.

**SYSTEM LOCATION:** Securities and Exchange Commission, Office of Administrative Services, 100 F Street, NE, Washington, DC 20549-1627.

**CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:**

Commission employees, members of the press, contractors, volunteers, tenants, and consultants or employees of other Federal agencies who require access to Commission facilities for extended periods of time.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Records include Government Personal Identity Verification (PIV) Card (The SEC PIV Card provider is the General Services Administration (GSA), and the full list of card fields maintained in the GSA system is covered by the GSA system of records, GSA-GOVT-7, Personal Identity Verification Identity Management System (PIV IDMS). The SEC system of records contains the following: name, date of birth, weight, height, color of hair and eyes, photograph, employee record number, card chip number, authorized access rights, date of issuance, date of return, date background investigation completed,

whether eligible for an SEC Special Credential [SEC Form 990], and date of expiration); SEC Form 980, Headquarters and Field Office Access Card (name, date of birth, weight, height, color of hair and eyes, photograph, employee record number, card chip number, authorized access rights, date of issuance, and date of expiration); SEC Form 980A, Day Pass (date, name, organization, and authorized by); SEC Form 990, Special Credential (signature of authorizing official, photograph, control number, date of issuance and date of expiration); SEC Form 2355, On-Site Business & Registered Client ID (name, requesting officer, name of company or organization, control number, identification number, date of issue, expiration date, relationship to business, date of birth, color of hair and eyes, height, weight, photograph, and authorized access rights); SEC Form 725, Identification/Access Control Card Worksheet (various personal characteristics); and local facility access card (name, authorized access rights, card number, date issued and date of expiration, company/agency name and SEC division/office).

NOTE: The extent to which the Commission has records of a personnel investigative nature that come from the Office of Personnel Management (OPM) or its contractors, they are covered by OPM/CENTRAL-9, Personnel Investigations Records, and not this system notice.

#### **AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

The Federal Property and Administrative Services Act of 1949 (63 Stat. 377), as amended; Homeland Security Presidential Directive 12 (HSPD-12), Policy for a Common Identification Standard for Federal Employees and Contractors, August 27, 2004.

**PURPOSE(S):**

This system is primarily designed to permit access according to authorized access rights to Commission facilities by Commission employees, contractors, consultants, volunteers, tenants, members of the press, and employees of other Federal agencies (only if they require access to Commission facilities for extended periods of time). This system also provides the status indicator of the PIV Cards to a separate secure database as required by Homeland Security Presidential Directive (HSPD) – 12 so that other Federal agencies may verify the identity and current status of the PIV cardholder.

**ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSE OF SUCH USES:**

These records and information contained in these records may be disclosed as follows:

1. To the appropriate Federal, State or local agency responsible for investigating, prosecuting, enforcing, or implementing a statute, rule, regulation, or order, where the Commission becomes aware of an indication of a violation or potential violation of civil or criminal law or regulation;
2. To another Federal agency or to a court when the Government is party to a judicial proceeding before the court;
3. To a Federal, State, or local agency, in response to its requests, in connection with the hiring or retention of an employee, the issuance of a security clearance, or the conducting of a security or background investigation of an individual, to the extent that the information is relevant and necessary to the requesting agency;
4. To the Office of Inspector General for investigating allegations of abuse, should it occur;
5. To other Federal agencies to verify the identity and status of the PIV Card holder;

6. To Commission contractors or their authorized employees, and other Federal agencies, as necessary, for the purpose of assisting the Commission in the efficient administration of its programs. These contractors will be required to maintain Privacy Act safeguards with respect to such records; and
7. In connection with organizational directories or similar records for internal management purposes.

**POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:**

**STORAGE:** Records are stored in electronic media and in paper files.

**RETRIEVABILITY:** Records may be retrieved by the employee's name or identification number.

**SAFEGUARDS:** Records are safeguarded by restricted computer passwords, locked file cabinets, and safes.

**RETENTION AND DISPOSAL:**

Records are maintained in a computerized database and paper. Electronic records, identification cards, and passes are destroyed three months after expiration, revocation, or return to issuing office, as provided in the National Archives and Records Administration's General Records Schedule No. 11, Item 4.

**SYSTEM MANAGER(S) AND ADDRESS:**

Office of Administrative Services, Security Branch, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1627.

**NOTIFICATION PROCEDURE:**

All requests to determine whether this system of records contains a record pertaining to the requesting individual may be directed to the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of this record may contact the Privacy Act Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORDS PROCEDURES:**

See record access procedures above.

**RECORD SOURCE CATEGORIES:**

The issuing official, Commission employee, contractor, volunteer, on-site business owner or client, employee of other Federal agency, visitor, or press member being issued the identification/access card provides the information.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

By the Commission.



Nancy M. Morris  
Secretary

Date: January 11, 2007



UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
January 11, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12531

In the Matter of

Combined Companies Corp.,  
Communication Ventures, Inc.,  
InTechnologies, Inc.,  
Repcor, Inc.,  
Sutra Management Corp.,  
Syndicate Ventures, Inc.,  
Transwave Corp.,  
Veda Corp., and  
1 Solution Corp.,

Respondents.

ORDER INSTITUTING  
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").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Combined Companies Corp. (CIK No. 1101997) is a void Delaware corporation located in Hopelawn, New Jersey, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company's original president is also the president of co-respondent Communication Ventures, Inc. Combined Companies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported no assets and an accumulated loss of \$22,646.

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2. Communication Ventures, Inc. (CIK No. 1102144) is a void Delaware corporation located in Malibu, California, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The president of the company is the original president of co-respondent Combined Companies Corp. Communication Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since a Form 10-QSB was filed for the period ended June 30, 2000, and that filing reported no assets and an accumulated loss of \$17,413.

3. InTechnologies, Inc. (f/k/a Jetco, Inc.) (CIK No. 1099804) is a void Delaware corporation located in St. George, Utah, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. was the original president of InTechnologies. InTechnologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000. That filing reported that the company had no assets and a net loss of \$272,080 for the nine months ended September 30, 2000.

4. Repco, Inc. (CIK No. 83179) is a void Delaware corporation located in Mt. Vernon, New York, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. was the CEO of Repco from 1990-95. Repco 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, 1990.

5. Sutra Management Corp. (CIK No. 1103110) is a void Delaware corporation located in Malibu, California, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. is also Sutra Management's president. Sutra Management is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported no assets and an accumulated loss of \$37,655. The company's stock is not publicly quoted or traded. On May 18, 2005, the Commission filed a complaint and obtained a temporary restraining order in the U.S. District Court for the Central District of California against Sutra Management and its CEO restraining them from violations of the registration and antifraud provisions of the federal securities laws. On November 18, 2005, the Commission obtained a permanent injunction against Sutra Management and its CEO enjoining them from selling unregistered securities.

6. Syndicate Ventures, Inc. (CIK No. 1101886) is a void Delaware corporation located in Malibu, California, with a class of equity securities registered with the Commission on December 29, 1999, pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. is also Syndicate Ventures' president. Syndicate Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported no assets and an accumulated loss of \$24,163.

7. Transwave Corp. (CIK No. 1103108) is a void Delaware corporation located in Sherman Oaks, California, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. is also the president of Transwave. Transwave is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2001, which reported no assets and a net loss of \$49,413 since inception.

8. Veda Corp. (CIK No. 1101303) is a void Delaware corporation located in Sherman Oaks, California, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. is the chairman of Veda. Veda is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2000, which reported no assets and an accumulated loss of \$17,424.

9. 1 Solution Corp. (CIK No. 1101417) is a void Delaware corporation located in Sherman Oaks, California, with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The current president of co-respondent Communication Ventures, Inc. is a director of 1 Solution Corp. 1 Solution is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported no assets and an accumulated loss of \$24,195.

#### B. DELINQUENT PERIODIC FILINGS

10. As discussed in more detail above, a common person was or is affiliated with all of the respondents as an officer or director, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), 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.

11 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 (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

12. As a result of the foregoing, Respondents 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 of this Order are true, and 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 to revoke the registrations of securities of the Respondent identified in Section II pursuant to Section 12 of the Exchange Act.

### 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 each 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 a 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 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 Respondent personally or by certified or registered mail or by other means of verifiable delivery.

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)].

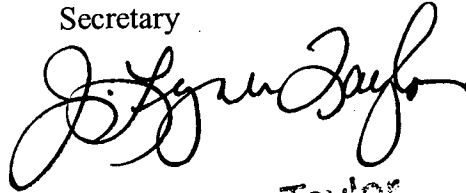
In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in 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.

Attachment

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

# Appendix 1

## Chart of Delinquent Filings

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Combined Companies Corp.</b>					
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent	24				
<b>Communication Ventures, Inc.</b>					
	10-QSB	09/30/00	11/14/00	Not filed	73
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Communication Ventures, Inc.</b>					
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 25

**InTechnologies, Inc.**

10-KSB	12/31/00	04/02/01	Not filed	68
10-QSB	03/31/01	05/15/01	Not filed	67
10-QSB	06/30/01	08/14/01	Not filed	64
10-QSB	09/30/01	11/14/01	Not filed	61
10-KSB	12/31/01	04/01/02	Not filed	56
10-QSB	03/31/02	05/15/02	Not filed	55
10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7
10-QSB	06/30/06	08/14/06	Not filed	4
10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 24

**REPCO, Inc.**

10-Q	03/31/90	05/15/90	Not filed	199
10-Q	06/30/90	08/14/90	Not filed	196
10-Q	09/30/90	11/14/90	Not filed	193

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
REPCO, Inc.					
	10-K	12/31/90	04/01/91	Filed late	7
	10-Q	03/31/91	05/15/91	Not filed	187
	10-Q	06/30/91	08/14/91	Not filed	184
	10-Q	09/30/91	11/14/91	Not filed	181
	10-K	12/31/91	03/30/92	Not filed	177
	10-Q	03/31/92	05/15/92	Not filed	175
	10-Q	06/30/92	08/14/92	Not filed	172
	10-Q	09/30/92	11/16/92	Not filed	169
	10-K	12/31/92	03/31/93	Not filed	165
	10-Q	03/31/93	05/15/93	Not filed	163
	10-Q	06/30/93	08/14/93	Not filed	160
	10-Q	09/30/93	11/15/93	Not filed	157
	10-K	12/31/93	03/31/94	Not filed	153
	10-Q	03/31/94	05/16/94	Not filed	151
	10-Q	06/30/94	08/15/94	Not filed	148
	10-Q	09/30/94	11/14/94	Not filed	145
	10-K	12/31/94	03/31/95	Not filed	141
	10-Q	03/31/95	05/15/95	Not filed	139
	10-Q	06/30/95	08/14/95	Not filed	136
	10-Q	09/30/95	11/14/95	Not filed	133
	10-K	12/31/95	04/01/96	Not filed	128
	10-Q	03/31/96	05/15/96	Not filed	127
	10-Q	06/30/96	08/14/96	Not filed	124
	10-Q	09/30/96	11/14/96	Not filed	121
	10-K	12/31/96	03/31/97	Not filed	117
	10-Q	03/31/97	05/15/97	Not filed	115
	10-Q	06/30/97	08/14/97	Not filed	112
	10-Q	09/30/97	11/14/97	Not filed	109
	10-K	12/31/97	03/31/98	Not filed	105
	10-Q	03/31/98	05/15/98	Not filed	103
	10-Q	06/30/98	08/14/98	Not filed	100
	10-Q	09/30/98	11/16/98	Not filed	97
	10-K	12/31/98	03/31/99	Not filed	93
	10-Q	03/31/99	05/17/99	Not filed	91
	10-Q	06/30/99	08/16/99	Not filed	88
	10-Q	09/30/99	11/15/99	Not filed	85
	10-K	12/31/99	03/30/00	Not filed	81
	10-Q	03/31/00	05/15/00	Not filed	79
	10-Q	06/30/00	08/14/00	Not filed	76
	10-Q	09/30/00	11/14/00	Not filed	73
	10-K	12/31/00	04/02/01	Not filed	68
	10-Q	03/31/01	05/15/01	Not filed	67
	10-Q	06/30/01	08/14/01	Not filed	64
	10-Q	09/30/01	11/14/01	Not filed	61
	10-K	12/31/01	04/01/02	Not filed	56
	10-Q	03/31/02	05/15/02	Not filed	55

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
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**REPCO, Inc.**

10-Q	06/30/02	08/14/02	Not filed	52
10-Q	09/30/02	11/14/02	Not filed	49
10-K	12/31/02	03/31/03	Not filed	45
10-Q	03/31/03	05/15/03	Not filed	43
10-Q	06/30/03	08/14/03	Not filed	40
10-Q	09/30/03	11/14/03	Not filed	37
10-K	12/31/03	03/30/04	Not filed	33
10-Q	03/31/04	05/17/04	Not filed	31
10-Q	03/31/06	05/15/06	Not filed	7
10-Q	06/30/04	08/16/04	Not filed	28
10-Q	09/30/04	11/15/04	Not filed	25
10-K	12/31/04	03/31/05	Not filed	21
10-Q	03/31/05	05/16/05	Not filed	19
10-Q	06/30/05	08/15/05	Not filed	16
10-Q	09/30/05	11/14/05	Not filed	13
10-K	12/31/05	03/31/06	Not filed	9
10-Q	03/31/06	05/15/06	Not filed	7
10-Q	06/30/06	08/14/06	Not filed	4
10-Q	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 68

**Sutra Management Corp.**

10-QSB	06/30/01	08/14/01	Not filed	64
10-QSB	09/30/01	11/14/01	Not filed	61
10-KSB	12/31/01	04/01/02	Not filed	56
10-QSB	03/31/02	05/15/02	Not filed	55
10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7
10-QSB	06/30/06	08/14/06	Not filed	4
10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 22

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Syndicate Ventures, Inc.</b>					
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 24

**Transwave Corp.**

10-QSB	03/31/02	05/15/02	Not filed	55
10-QSB	06/30/02	08/14/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	49
10-KSB	12/31/02	03/31/03	Not filed	45
10-QSB	03/31/03	05/15/03	Not filed	43
10-QSB	06/30/03	08/14/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	37
10-KSB	12/31/03	03/30/04	Not filed	33
10-QSB	03/31/04	05/17/04	Not filed	31
10-QSB	06/30/04	08/16/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	25
10-KSB	12/31/04	03/31/05	Not filed	21
10-QSB	03/31/05	05/16/05	Not filed	19
10-QSB	06/30/05	08/15/05	Not filed	16
10-QSB	09/30/05	11/14/05	Not filed	13
10-KSB	12/31/05	03/31/06	Not filed	9
10-QSB	03/31/06	05/15/06	Not filed	7

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Transwave Corp.</b>					
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent	19				

<b>Veda Corp.</b>					
	10-QSB	09/30/00	11/14/00	Not filed	73
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent	25				

<b>1 Solution Corp.</b>					
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
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**1 Solution Corp.**

<i>10-QSB</i>	06/30/03	08/14/03	Not filed	40
<i>10-QSB</i>	09/30/03	11/14/03	Not filed	37
<i>10-KSB</i>	12/31/03	03/30/04	Not filed	33
<i>10-QSB</i>	03/31/04	05/17/04	Not filed	31
<i>10-QSB</i>	06/30/04	08/16/04	Not filed	28
<i>10-QSB</i>	09/30/04	11/15/04	Not filed	25
<i>10-KSB</i>	12/31/04	03/31/05	Not filed	21
<i>10-QSB</i>	03/31/05	05/16/05	Not filed	19
<i>10-QSB</i>	06/30/05	08/15/05	Not filed	16
<i>10-QSB</i>	09/30/05	11/14/05	Not filed	13
<i>10-KSB</i>	12/31/05	03/31/06	Not filed	9
<i>10-QSB</i>	03/31/06	05/15/06	Not filed	7
<i>10-QSB</i>	06/30/06	08/14/06	Not filed	4
<i>10-QSB</i>	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent      24

UNITED STATES OF AMERICA

Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 55097 / January 12, 2007

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 2540 / January 12, 2007

ADMINISTRATIVE PROCEEDING

File No. 3-12535

In the Matter of

Lattice Semiconductor Corp.

Respondent.

ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING A  
CEASE-AND-DESIST ORDER  
PURSUANT TO SECTION 21C OF  
THE SECURITIES EXCHANGE ACT  
OF 1934

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 Lattice Semiconductor Corp. ("Lattice" 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 Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C 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:

Document 17 of 54

## SUMMARY

This is a financial reporting case in which inadequate internal controls caused Oregon-based Lattice Semiconductor Corp. to file inaccurate Forms 10-Q for the second and third quarters of 2003. By failing to segregate duties concerning the creation and entry of journal entries into the general ledger and failing to modernize and integrate its accounting system, Lattice contributed to the former controller's ability to enter unsupported journal entries totaling \$5.5 million and to conceal such entries for seven months from senior management and Lattice's auditor. These unsupported entries led Lattice to restate its financial statements for the first three quarters of 2003 in April 2004<sup>1</sup>, reducing previously reported revenue by \$10.6 million (an approximate 6% decrease) and increasing previously reported loss by \$8.9 million (an approximate 13% increase). As a result, Lattice violated the reporting, books and records, and internal controls provisions of the Exchange Act.

### **A. RESPONDENT**

**Lattice Semiconductor Corp.**, a Delaware corporation headquartered in Hillsboro, Oregon, designs, manufactures, and sells semiconductor products. Lattice's stock is registered under Section 12(g) of the Exchange Act and trades on the Nasdaq National Market.

### **B. FACTS**

#### **1. Lattice's Business and Deferred Revenue Accounting**

Lattice manufactures semiconductor products and sells them to end users directly and through distributors. Sales to distributors account for nearly half of Lattice's revenue. Lattice delays revenue recognition on sales to distributors until the distributors report product resale to Lattice. Lattice uses deferred income accounting to reflect the anticipated revenue and corresponding costs for its products shipped to distributors but not yet sold to end users. For example, when Lattice ships a product to a distributor, it records in its general ledger the list price as a credit to deferred revenue and the cost of the product as a debit to deferred cost. Deferred income is the balance sheet liability account reflecting deferred revenue less deferred cost.

#### **2. The Cross-Check of the Deferred Revenue Account in the General Ledger**

At the close of each quarter, the former controller<sup>2</sup> performed an account reconciliation to cross-check the accuracy of Lattice's estimate of deferred revenue as reflected in its general ledger. This account reconciliation was based on the carrying value of the Lattice inventory sitting on distributors' shelves and provided an estimate of the minimum deferred revenue balance required to reflect sales of this inventory. Lattice's accounting policies provided that if there was no material discrepancy between the account reconciliation estimate of deferred revenue and the estimate of deferred revenue reflected in Lattice's general ledger, the general ledger was accurate and the books could be closed for the quarter.

---

<sup>1</sup> Although Lattice restated its financial statements for the first quarter of 2003, that first quarter restatement is not addressed in this Order.

<sup>2</sup> The Commission instituted settled Administrative and Cease-and-Desist Proceedings against the former controller, Ronald Lee Hoyt, CPA, on September 30, 2005, in which Hoyt agreed not to practice before the Commission for three years.

### **3. The Discrepancies and Unsupported Journal Entries**

#### **(a) The Second Quarter 2003 Discrepancy of \$1.3 Million and the Unsupported Journal Entries to Reconcile the Discrepancy**

In July 2003, the former controller performed his usual reconciliation of the deferred revenue account in connection with his preparation of quarterly financial statements. The reconciliation showed that the estimate of deferred revenue was \$1.3 million higher than the deferred revenue balance on the general ledger, indicating an understatement of Lattice's deferred revenue and that Lattice had prematurely recognized revenue. Exploiting weaknesses in Lattice's internal controls, the former controller then wrote and caused the entry of two unsupported journal entries totaling \$1.3 million to offset the imbalance between the estimate of deferred revenue derived from the account reconciliation and the estimate of deferred revenue in the general ledger. These journal entries consisted primarily of credits (increases) to deferred revenue and debits (reductions) to accrued accounts payable instead of debits (reductions) to revenue. After making the unsupported journal entries, the former controller closed the books for the quarter. As a result, Lattice recognized revenue prematurely.

#### **(b) The Third Quarter Discrepancy of \$5.5 Million and the Unsupported Journal Entries to Reconcile the Discrepancy**

At the end of the third quarter, the former controller again performed his customary reconciliation to cross-check the amount of deferred revenue recorded in the general ledger. This time, the discrepancy was \$5.5 million. The former controller, again exploiting weaknesses in the company's internal controls, then wrote and caused the entry of several unsupported journal entries, totaling \$5.5 million (inclusive of the \$1.3 million of unsupported journal entries from the second quarter), to offset the imbalance and close the books for the quarter.

The use of unsupported journal entries in the second and third quarters of 2003 contributed to Lattice's recognition of revenue contrary to Generally Accepted Accounting Principles (GAAP). Statement of Financial Accounting Concepts No. 5, "Recognition and Measurement in Financial Statements of Business Enterprises" (CON 5), provides that "revenues are considered to be earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenue." CON 5 Para. 83. Accounting Research Bulletin No. 43 (ARB 43) provides that "Profit is deemed to be realized when a sale in the ordinary course of business is effected . . ." ARB 43 Chapter 1.A.1.

### **4. Lattice's Internal Investigation and Restatement**

On January 12, 2004, the former controller disclosed to Lattice's former VP of finance<sup>3</sup> the second and third quarter general ledger imbalances of \$1.3 and \$5.5 million, respectively. When Lattice learned about the unsupported journal entries, it relieved the former controller of responsibility for journal entries and the general ledger and began an internal investigation. The audit committee subsequently hired independent outside counsel to investigate. As described more fully below, the investigations identified material internal controls weaknesses and resulted in changes to the method of estimating deferred revenue and restatements of all 2003 Forms 10-Q on April 19, 2004. The restatements reduced previously reported revenue by \$10.6 million (an approximate 6% decrease) and increased previously reported net loss by \$8.9 million (an approximate 13% increase).

<sup>3</sup> The former VP of Finance terminated employment with Lattice in August 2005.

## **5. Lattice's Internal Controls Weaknesses**

In the relevant period, Lattice had two material weaknesses in the design and operation of its internal controls: failure to segregate duties concerning journal entries and failure to recognize that its method of calculating deferred revenue had become inaccurate over time.

With respect to Lattice's failure to segregate duties, Lattice's accounting practices enabled the former controller to have sole review and approval of all journal entries and gave him access to the general ledger. The lack of segregation allowed the former controller to make the unsupported journal entries without review. Lattice's dependence on the former controller was such that, although it terminated him in March 2004, it hired him three days later as a consultant to assist with the quarterly filing.

At least a year before the former controller's misconduct, Lattice's auditor orally notified Lattice's former VP of finance that the lack of segregation of duties for journal entries and general ledger reconciliation was an internal controls weakness. However, no changes to Lattice's controls were made.

The second material control weakness related to Lattice's failure to integrate its accounting system. In particular, Lattice's accounting system failed to recognize that a percentage used in its account reconciliation methodology to estimate deferred revenue had become inaccurate over time because the accounting system had not been properly integrated to precisely determine the effects of sales discounts. During the relevant period, Lattice had not been collecting as large a percentage of cash from its distributors as it had historically, and Lattice's finance staff did not have adequate systems or personnel to account for the effects of this change. The failure to recognize the drop in percentage of cash collected also caused Lattice to overstate the amount of previously deferred revenue taken into income.

## **C. VIOLATIONS**

### **1. Reporting Violations: Section 13(a) of the Exchange Act and Rule 13a-13 Thereunder**

Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act, such as Lattice, to file quarterly reports with the Commission and to keep this information current. The obligation to file such reports embodies the requirement that they be true and correct. See, e.g., *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978). Lattice violated these provisions by filing materially inaccurate Forms 10-Q for the second and third quarters of 2003.

### **2. Record-Keeping Violation: Section 13(b)(2)(A) of the Exchange Act**

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Lattice's books and records inaccurately reflected the transactions and disposition of assets for the second and third quarters of 2003, in violation of Section 13(b)(2)(A).

3. **Internal Control Violation: Section 13(b)(2)(B) of the Exchange Act**

Section 13(b)(2)(B) requires issuers with securities registered under Section 12 of the Exchange Act to devise and maintain a system of internal accounting controls sufficient to reasonably assure, among other things, that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP.

Lattice had two primary areas of material weakness in the design and operation of internal controls: segregation of duties and failure to update its estimate methodology. These material weaknesses contributed to the former controller's ability to make and conceal the unsupported journal entries. Lattice therefore violated Section 13(b)(2)(B) of the Exchange Act.

D. **REMEDIAL EFFORTS**

In determining to accept the Offer, the Commission considered Lattice's cooperation and remedial actions.

IV.

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

Accordingly, it is hereby ORDERED that Respondent Lattice 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 Rule 13a-13 thereunder.

By the Commission.

Nancy M. Morris  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55093 / January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12533**

**In the Matter of**

**OCA, Inc.,**

**Respondent.**

**ORDER INSTITUTING PROCEEDINGS, MAKING  
FINDINGS, AND REVOKING REGISTRATION OF  
SECURITIES 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 proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against OCA, Inc. ("OCA" 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, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

*Document 18 of 54*

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that

A. OCA, a Delaware corporation based in Metairie, Louisiana, provides business services to orthodontic and dental practices worldwide. The common stock of OCA has been registered under Section 12 of the Exchange Act, 15 U.S.C. §781, since 1994. Prior to November 8, 2005, OCA stock was listed and traded on The New York Stock Exchange. It is currently quoted on the "Pink Sheets" disseminated by Pink Sheets LLC.

B. OCA has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, 17 C.F.R. §§ 270.13a-1 and -13, while its common stock was registered with the Commission in that it has not filed an annual report on Form 10-K since its 2003 Form 10-K or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending September 30, 2004.

### 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.

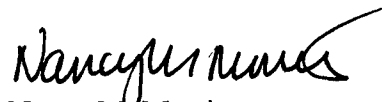
In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

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<sup>1</sup> 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.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Repondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.



Nancy M. Morris  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55094 / January 12, 2007

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 2539 / January 12, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12534

In the Matter of

CHARLES R. EISENSTEIN,

Respondent.

ORDER OF SUSPENSION PURSUANT  
TO RULE 102(e)(2) OF THE  
COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension of Charles R. Eisenstein ("Eisenstein"), pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. §200.102(e)(2)].<sup>1</sup>

II.

The Commission finds that:

1. Eisenstein, age 56 of Brooklyn, New York, is not, nor has he ever been at any time relevant to this proceeding, a certified public accountant ("CPA") licensed to practice in any jurisdiction or before the Commission.<sup>2</sup>

2. On August 12, 2002, Eisenstein pled guilty to one count of securities fraud in

<sup>1</sup> Rule 102(e)(2) provides in pertinent part: Any . . . person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

<sup>2</sup> In an audit report filed with a Form 8-K with the Commission, Eisenstein falsely represented that he was a CPA and that he had audited the financial statements of the public company.

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violation of Title 15 of the United States Code, Sections 78j(b) and 78ff before the United States District Court for the Southern District of New York, in United States v. Charles Eisenstein, Crim. Information No. 1:02-CR-905. On March 10, 2003, a judgment in the criminal case was entered against Eisenstein, he was sentenced to 2 years probation and ordered to pay fines in the amount of \$2,500.

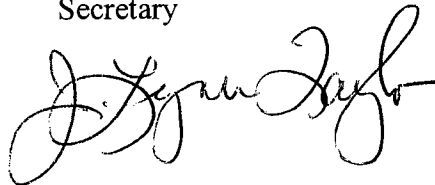
**III.**

In view of the foregoing, the Commission finds that Eisenstein has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, IT IS ORDERED, that Eisenstein is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

**By: J. Lynn Taylor**  
**Assistant Secretary**

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

JAN 12 2007

In the Matter of

Pathways Group, Inc. (n/k/a  
Bicoastal Communications, Inc.)

File No. 500-1

ORDER OF SUSPENSION OF TRADING

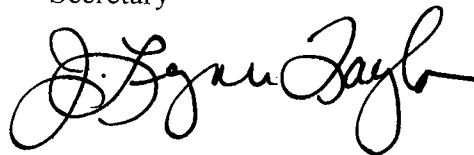
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Pathways Group, Inc. (n/k/a Bicoastal Communications, Inc.) because it has not filed any periodic reports since the period ended September 30, 2000.

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 securities of the above-listed company is suspended for the period from 9:30 a.m. EST on January 12, 2007, through 11:59 p.m. EST on January 26, 2007.

By the Commission.

Nancy M. Morris  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

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**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**  
**January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12532**

**In the Matter of**

**Buffalo Capital V, Ltd. (n/k/a  
Aladdin Oil Corp.),  
Echo Springs Water Company, Inc.,  
Isolver.Com, Inc., and  
Pathways Group, Inc. (n/k/a  
Bicoastal Communications, 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").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Buffalo Capital V, Ltd. ("Buffalo") (n/k/a Aladdin Oil Corp.) (CIK No. 1047296) is a dissolved Colorado corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Buffalo is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1999, which reported a net loss of \$514,749 for the prior nine months. On June 28, 1999, Buffalo changed its name to Aladdin Oil Corp. Although Buffalo filed a Form 8-K disclosing the name change, it failed to update its EDGAR filer information in the Commission's computer records as required by Commission rules. As of January 9, 2006, the company's stock (symbol "ADDN") was not publicly quoted or traded.

2. Echo Springs Water Company, Inc. ("Echo Springs") (CIK No. 826144) is a void New York corporation located in Kearny, New Jersey with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Echo

*Document 21 of 54*

Springs is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 1999, which reported a net loss of \$592,753 for the prior nine months.

3. Isolver.Com, Inc. ("Isolver.Com") (CIK No. 1047294) is a delinquent Colorado corporation located in Van Nuys, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Isolver.Com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2000, which reported no revenues and a net loss of \$221,096. As of December 21, 2006 the company's stock (symbol "ISLV") was traded on the over-the-counter markets.

4. Pathways Group, Inc. ("Pathways Group") (n/k/a Bicoastal Communications, Inc.) (CIK No. 1039759) is a void Delaware corporation located in Woodinville, Washington with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Pathways Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$2.5 million. In April 2005, the company changed its name to Bicoastal Communications, Inc. with the State of Delaware but failed to update its EDGAR filer information in the Commission's computer records as required by Commission rules. As of December 21, 2006, the company's stock (symbol "BCLC") was quoted on the Pink Sheets, had fifteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

## B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), 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. Moreover, all of the respondents at various times had one or more affiliated persons with a connection to an issuer not named in this proceeding.

6. 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 (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

7. As a result of the foregoing, Respondents 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 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 of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

### 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 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 each Respondent personally, by certified or express mail, or by any other means permitted by the Commission's 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)].

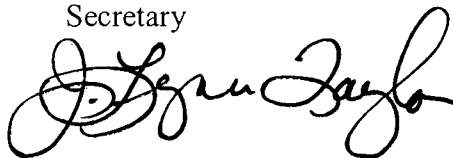
In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in 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.

Attachment

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

## Appendix 1

### Chart of Delinquent Filings

*In the Matter of Buffalo Capital V, Ltd. (n/k/a Aladdin Oil Corp.), et al.*

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Buffalo Capital V, Ltd.</b>					
<b>(n/k/a Aladdin Oil Corp.)</b>					
	10-KSB	12/31/99	03/30/00	Not filed	81
	10-QSB	03/31/00	05/15/00	Not filed	79
	10-QSB	06/30/00	08/14/00	Not filed	76
	10-QSB	09/30/00	11/14/00	Not filed	73
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent	28				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Echo Springs Water Co., Inc.</b>	10-KSB	10/31/99	01/31/00	Not filed	83
	10-QSB	01/31/00	03/16/00	Not filed	81
	10-QSB	04/30/00	06/14/00	Not filed	78
	10-QSB	07/31/00	09/14/00	Not filed	75
	10-KSB	10/31/00	01/29/01	Not filed	71
	10-QSB	01/31/01	03/19/01	Not filed	69
	10-QSB	04/30/01	06/14/01	Not filed	66
	10-QSB	07/31/01	09/14/01	Not filed	63
	10-KSB	10/31/01	01/29/02	Not filed	59
	10-QSB	01/31/02	03/18/02	Not filed	57
	10-QSB	04/30/02	06/14/02	Not filed	54
	10-QSB	07/31/02	09/16/02	Not filed	51
	10-KSB	10/31/02	01/29/03	Not filed	47
	10-QSB	01/31/03	03/17/03	Not filed	45
	10-QSB	04/30/03	06/16/03	Not filed	42
	10-QSB	07/31/03	09/15/03	Not filed	39
	10-KSB	10/31/03	01/29/04	Not filed	35
	10-QSB	01/31/04	03/16/04	Not filed	33
	10-QSB	04/30/04	06/14/04	Not filed	30
	10-QSB	07/31/04	09/14/04	Not filed	27
	10-KSB	10/31/04	01/31/05	Not filed	23
	10-QSB	01/31/05	03/17/05	Not filed	21
	10-QSB	04/30/05	06/14/05	Not filed	18
	10-QSB	07/31/05	09/14/05	Not filed	15
	10-KSB	10/31/05	01/30/06	Not filed	11
	10-QSB	01/31/06	03/17/06	Not filed	9
	10-QSB	04/30/06	06/14/06	Not filed	6
	10-QSB	07/31/06	09/14/06	Not filed	3
<b>Total Filings Delinquent</b>		28			

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<i>Isolver.Com, Inc.</i>					
	10-QSB	09/30/00	11/14/00	Not filed	73
	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1
Total Filings Delinquent		24			

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<i>Pathways Group, Inc.</i>	10-KSB	12/31/00	04/02/01	Not filed	68
	10-QSB	03/31/01	05/15/01	Not filed	67
	10-QSB	06/30/01	08/14/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	61
	10-KSB	12/31/01	04/01/02	Not filed	56
	10-QSB	03/31/02	05/15/02	Not filed	55
	10-QSB	06/30/02	08/14/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	49
	10-KSB	12/31/02	03/31/03	Not filed	45
	10-QSB	03/31/03	05/15/03	Not filed	43
	10-QSB	06/30/03	08/14/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	37
	10-KSB	12/31/03	03/30/04	Not filed	33
	10-QSB	03/31/04	05/17/04	Not filed	31
	10-QSB	06/30/04	08/16/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	25
	10-KSB	12/31/04	03/31/05	Not filed	21
	10-QSB	03/31/05	05/16/05	Not filed	19
	10-QSB	06/30/05	08/15/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	13
	10-KSB	12/31/05	03/31/06	Not filed	9
	10-QSB	03/31/06	05/15/06	Not filed	7
	10-QSB	06/30/06	08/14/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	1

Total Filings Delinquent 24

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8771A / January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12537**

**In the Matter of**

**EMANUEL J. FRIEDMAN,**  
  
**Respondent**

**CORRECTED ORDER UNDER  
RULE 602(e) OF THE SECURITIES  
ACT OF 1933 GRANTING TO  
EJF CAPITAL LLC A WAIVER OF  
THE DISQUALIFICATION  
PROVISIONS OF RULES 602(c)(2)  
AND 602(c)(3)**

Counsel for Emanuel J. Friedman ("Friedman") and EJF Capital LLC ("EJF"), at the request of Friedman, has submitted a letter, dated November 29, 2006, requesting, on behalf of EJF, a waiver of the disqualification from the exemption from registration under Regulation E arising from the settlement of an injunctive proceeding in federal court and an administrative proceeding commenced by the Commission against Friedman, EJF's chief executive officer and majority shareholder.

On December 22, 2006, pursuant to Friedman's Consent, the United States District Court for the District of Columbia entered a Final Judgment permanently enjoining Friedman from violating Section 5 of the Securities Act of 1933 ("Securities Act") and, as a controlling person, from violating Sections 10(b) and 15(f) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. The Final Judgment also ordered Friedman to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act and Sections 21(d) and 21A of the Exchange Act.

In addition, on January 12, 2007, pursuant to Friedman's Offer of Settlement, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions against Friedman. Under the Order, the Commission found that Friedman was enjoined from violations of Section 5 of the Securities Act and, as a controlling person, from violations of Sections 10(b) and 15(f) of the Exchange Act and Rule 10b-5 thereunder. In the Order, the Commission barred Friedman from association in a supervisory capacity with any broker or dealer with a right to reapply for such association after two years.

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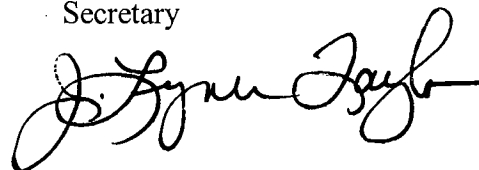
The Regulation E exemption is not available for the securities of an issuer if, among other things, any partner, director or officer of an investment adviser or underwriter of the securities to be offered is temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser. Rule 602(c)(2). The Regulation E exemption also is not available to an issuer if, among other things, any partner, director or officer of an investment adviser or underwriter of the securities to be offered, is subject to a Commission order pursuant to Section 15(b) of the Exchange Act. Rule 602(c)(3). However, Rule 602(e) provides that disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances, that the exemption be denied."

Based upon the representations set forth in the request on behalf of EJF, the Commission has determined that pursuant to Rule 602(e) a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as to EJF as a result of the Final Judgment or the Order.

Accordingly, IT IS ORDERED, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rules 602(c)(2) and 602(c)(3) under the Securities Act resulting from the entry of the Final Judgment and the Order, respectively, is hereby granted to EJF Capital LLC.

By the Commission.

Nancy M. Morris  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**

Release No. 8772 / January 12, 2007

**SECURITIES EXCHANGE ACT OF 1934**

Release No. 55106 / January 12, 2007

**ADMINISTRATIVE PROCEEDING**

File No. 3-12538

In the Matter of

**FRIEDMAN, BILLINGS,  
RAMSEY & CO., INC.,**

**Respondent.**

**ORDER UNDER SECTION 27A(b) OF  
THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b) OF THE  
SECURITIES EXCHANGE ACT OF  
1934 GRANTING WAIVERS OF THE  
DISQUALIFICATION PROVISIONS  
OF SECTION 27A(b)(1)(A)(ii) OF THE  
SECURITIES ACT AND SECTION  
21E(b)(1)(A)(ii) OF THE EXCHANGE  
ACT**

Friedman, Billings, Ramsey & Co., Inc. ("FBR") has submitted a letter, dated January 10, 2006, requesting waivers of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from FBR's settlement of an injunctive proceeding in federal court and an administrative proceeding commenced by the Commission.

On December 22, 2006, pursuant to FBR's Consent, the United States District Court for the District of Columbia entered a Final Judgment permanently enjoining FBR from violating Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(f) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. The Final Judgment also ordered FBR to disgorge ill-gotten gains and to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act and Sections 21(d) and 21A of the Exchange Act.

In addition, on January 12, 2007, pursuant to FBR's Offer of Settlement, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions against FBR. Under the Order, the Commission found that FBR was enjoined from violations of Sections 5 and 17(a) of the Securities Act and Sections 10(b) and 15(f) of the Exchange Act and Rule 10b-5 thereunder. In the Order, the Commission censured FBR and ordered it to comply with certain undertakings.

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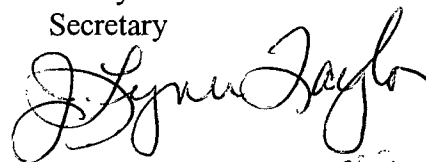
The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of the issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Securities Act, Section 27A(b)(1)(A)(ii); Exchange Act, Section 21E(b)(1)(A)(ii). The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Securities Act, Section 27A(b); Exchange Act, Section 21E(b).

Based upon the representations set forth in FBR's January 10, 2006 request, the Commission has determined that under the circumstances, the request for waivers of the disqualifications resulting from the entry of the Final Judgment and the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that waivers from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act resulting from the entry of the Final Judgment and the Order are hereby granted.

By the Commission.

Nancy M. Morris  
Secretary



**By: J. Lynn Taylor**  
**Assistant Secretary**

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8773 / January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12538**

**In the Matter of**

**FRIEDMAN, BILLINGS,  
RAMSEY & CO., INC.,**

**Respondent.**

**ORDER UNDER RULE 602(e) OF  
THE SECURITIES ACT OF 1933  
GRANTING A WAIVER OF THE  
DISQUALIFICATION PROVISIONS  
OF RULES 602(b)(4), 602(c)(2) AND  
602(c)(3)**

Friedman, Billings, Ramsey & Co., Inc. ("FBR") has submitted a letter, dated November 28, 2006, requesting a waiver of the disqualification from the exemption from registration under Regulation E arising from FBR's settlement of an injunctive proceeding in federal court and an administrative proceeding commenced by the Commission.

On December 22, 2006, pursuant to FBR's Consent, the United States District Court for the District of Columbia entered a Final Judgment permanently enjoining FBR from violating Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(f) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. The Final Judgment also ordered FBR to disgorge ill-gotten gains and to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act and Sections 21(d) and 21A of the Exchange Act.

In addition, on January 12, 2007, pursuant to FBR's Offer of Settlement, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions against FBR. Under the Order, the Commission found that FBR was enjoined from violations of Sections 5 and 17(a) of the Securities Act and Sections 10(b) and 15(f) of the Exchange Act and Rule 10b-5 thereunder. In the Order, the Commission censured FBR and ordered it to comply with certain undertakings.

The Regulation E exemption is not available for the securities of an issuer if the issuer or any of its affiliates is subject to any order, judgment, or decree of a court "temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of securities." Rule 602(b)(4). The Regulation E exemption also is not available for the securities of an

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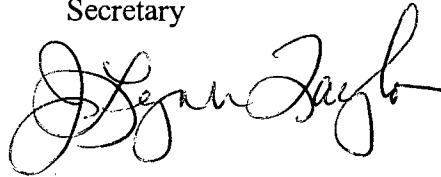
issuer if a director, officer, principal security holder, investment adviser or underwriter of the securities to be offered, or any partner, director or officer of such investment adviser or underwriter, is temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser. Rule 602(c)(2). The Regulation E exemption further is not available to an issuer if a director, officer, principal security holder, investment adviser or underwriter of the securities to be offered, or any partner, director or officer of such investment adviser or underwriter, is subject to a Commission order pursuant to Section 15(b) of the Exchange Act. Rule 602(c)(3). However, Rule 602(e) provides that disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances, that the exemption be denied."

Based upon the representations set forth in FBR's request, the Commission has determined that pursuant to Rule 602(e) a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Final Judgment or the Order.

Accordingly, IT IS ORDERED, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rules 602(b)(4), 602(c)(2) and 602(c)(3) under the Securities Act resulting from the entry of the Final Judgment and the Order, respectively, is hereby granted.

By the Commission.

Nancy M. Morris  
Secretary



**By: J. Lynn Taylor**  
**Assistant Secretary**

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55104 / January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12537**

**In the Matter of**

**EMANUEL J. FRIEDMAN,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b)(6) 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)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Emanuel J. Friedman ("Friedman" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Friedman 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, Friedman consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) 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 Friedman's Offer, the Commission finds that:

1. From 1989 until April 26, 2005, Friedman was a registered representative of Friedman, Billings, Ramsey & Co., Inc. ('FBR'), a registered broker-dealer. For his entire tenure at FBR, Friedman was either the chairman or co-chairman and either the chief executive officer or co-chief executive officer of that firm. Friedman, 60 years old, is a resident of the District of Columbia.

2. On December 22, 2006, a final judgment was entered by consent against Friedman, permanently enjoining him from violating Section 5 of the Securities Act of 1933 ('Securities Act') and, as a controlling person pursuant to Section 20(a) of the Exchange Act, from violating, directly or indirectly, Sections 10(b) and 15(f) of the Exchange Act and Rule 10b-5 promulgated thereunder, in the civil action entitled Securities and Exchange Commission v. Friedman, Billings, Ramsey & Co., Inc., et al., Civil Action Number 06-CV-02160, in the United States District Court for the District of Columbia.

3. The Commission's complaint alleged that in September and October 2001, Friedman, along with others, had responsibility for, actively participated in and directed or controlled, the day-to-day management of FBR. In particular, the complaint alleged that Friedman, among other things, was a member of FBR's underwriting committee, participated in meetings regarding the progress of investment banking transactions and supervised FBR's compliance and trading departments. Accordingly, the complaint alleged that Friedman was a controlling person of FBR pursuant to Section 20(a) of the Exchange Act. The complaint also alleged that, in connection with a Private Investment in Public Equity ('PIPE') offering by CompuDyne Corporation ('CompuDyne'), FBR failed to establish, maintain and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information and, in violation of the antifraud provisions of the federal securities laws, improperly traded CompuDyne stock in its market making account while aware of material, nonpublic information concerning the CompuDyne PIPE offering. The complaint further alleged that Friedman, as a controlling person, is liable for the foregoing conduct by FBR. The complaint also alleged that FBR and Friedman engaged in unregistered sales of CompuDyne 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 Friedman's Offer.

Accordingly, it is hereby ORDERED:

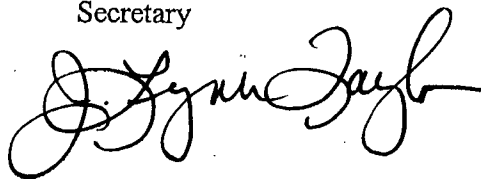
Pursuant to Section 15(b)(6) of the Exchange Act, Friedman be, and hereby is, barred from association in a supervisory capacity with any broker or dealer, with the right to reapply for such

association after two years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by Friedman 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 Friedman, 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.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55105 / January 12, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12538**

**In the Matter of**

**FRIEDMAN, BILLINGS,  
RAMSEY & CO., INC.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b)(4) 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)(4) of the Securities Exchange Act of 1934 ("Exchange Act") against Friedman, Billings, Ramsey & Co., Inc. ("FBR" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, FBR 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, and the findings contained in Section III.2 below, which are admitted, FBR consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

*Document 26 of 54*

### III.

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

1. From January 25, 1989 until present, FBR has been a broker-dealer registered with the Commission. FBR, a Delaware corporation, is a subsidiary of Friedman, Billings, Ramsey Group, Inc. ("FBG"), a holding company for several entities that provide investment banking, institutional brokerage, specialized asset management and banking products and services. FBG is a Virginia corporation with its principal place of business in Arlington, Virginia, whose stock is traded on the New York Stock Exchange under the symbol "FBR."
2. On December 22, 2006, a final judgment was entered by consent against FBR, permanently enjoining FBR from violating Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(f) of the Exchange Act and Rule 10b-5 promulgated thereunder, in the civil action entitled Securities and Exchange Commission v. Friedman, Billings, Ramsey & Co., Inc., et al., Civil Action Number 06-CV-02160, in the United States District Court for the District of Columbia.
3. The Commission's complaint alleged that, in connection with a Private Investment in Public Equity ("PIPE") offering<sup>1</sup> of stock by CompuDyne Corporation ("CompuDyne"), FBR failed to establish, maintain and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information and, in violation of the antifraud provisions of the federal securities laws, improperly traded CompuDyne stock in its market making account while aware of material, nonpublic information concerning the CompuDyne PIPE offering. In particular, the complaint alleged that while FBR had policies and procedures relating to the handling of material, nonpublic information, those policies and procedures were not reasonably designed to prevent the misuse of material, nonpublic information, and were not enforced by FBR, in connection with the CompuDyne PIPE transaction. The complaint also alleged that FBR entered into a written engagement agreement to act as the placement agent for the CompuDyne PIPE offering, which, among other things, required FBR to keep information that it learned about the PIPE offering confidential until such information became public. The complaint further alleged that as a result of this engagement, FBR learned material, nonpublic information regarding the CompuDyne offering and breached a duty of trust and confidence that it owed to CompuDyne when it traded in its market making account while aware of such material, nonpublic

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<sup>1</sup> In a PIPE transaction, a "placement agent" or underwriter privately places restricted securities of a public company with investors meeting certain criteria ("accredited investors"). Accredited investors enter into a purchase agreement with the public company committing the investors to purchase a certain number of shares at a specified price. The public company agrees, in turn, to file a resale registration statement with the Commission within a specified period so that the investors can resell the shares to the public. The investors do not pay for the shares until the closing of the transaction, which does not occur until a short time before or after the resale registration statement is declared effective.

information. The complaint also alleged that FBR engaged in unregistered sales of CompuDyne securities.

#### Undertakings

4. FBR undertakes the following:

a. FBR shall retain, within 30 days from the date of entry of the Order, the services of an Independent Consultant, who is not unacceptable to the Commission's staff. FBR shall require the Independent Consultant to perform all of the services and tasks described below. FBR shall exclusively bear all costs, including compensation and expenses, associated with the retention and performance of the Independent Consultant.

b. FBR shall require the Independent Consultant to conduct a comprehensive review and prepare a written report ("Initial Report") regarding FBR's policies, procedures and practices to prevent the misuse of material nonpublic information, which are required by Section 15(f) of the Exchange Act. FBR shall require the Independent Consultant to issue and deliver to FBR and the Commission's staff the Initial Report within 90 days from the date of entry of the Order. The Initial Report must include a description of the review performed, the conclusions reached, and the Independent Consultant's recommendations as to how FBR should improve, modify or supplement its policies and procedures to prevent the misuse of material nonpublic information in order to be in compliance with Section 15(f) of the Exchange Act.

c. FBR shall adopt all recommendations in the Initial Report, provided, however, that within 30 days after the Independent Consultant delivers the Initial Report, FBR shall in writing advise the Independent Consultant and the Commission's staff of any recommendations that it considers unduly burdensome, impractical or costly. FBR need not adopt such recommendations at that time but shall propose in writing an alternative policy or procedure designed to achieve the same objective or purpose. As to any recommendations on which FBR and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 30 days after FBR delivers the written advice. In the event FBR and the Independent Consultant are able to agree on an alternative proposal, such proposal must not be unacceptable to the Commission's staff. In the event FBR and the Independent Consultant are unable to agree on an alternative proposal, FBR shall abide by the determination of the Independent Consultant.

d. FBR shall, within six months after the issuance of the Independent Consultant's Initial Report, submit to the Commission's staff an affidavit attesting to its implementation of the recommendations contained in the Initial Report and setting forth the details of its implementation of the recommendations contained in the Initial Report.

e. FBR shall, within one year after the issuance of the Initial Report, require the Independent Consultant to review FBR's policies, procedures and practices to

prevent the misuse of material, nonpublic information, as required by Section 15(f) of the Exchange Act, and deliver to FBR and the Commission's staff a final written report ("Final Report") analyzing FBR's adoption, implementation, maintenance and enforcement of the policies, procedures and practices contained in the Initial Report and the effectiveness of those policies, procedures, and practices.

f. To ensure the independence of the Independent Consultant, FBR: (i) shall not have the authority to terminate the Independent Consultant, without the prior written approval of the Commission's staff; (ii) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to the Order at their reasonable and customary rates; and (iii) 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.

g. To further ensure the independence of the Independent Consultant, FBR shall require the Independent Consultant to enter into an agreement that provides for the period of the 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 FBR, 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 Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with FBR 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.

h. FBR shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with prompt access to FBR's files, books, records and personnel as the Independent Consultant reasonably deems necessary or appropriate in fulfilling any function or completing any task described in these undertakings.

i. For good cause shown, and upon receipt of a timely application from the Independent Consultant or FBR, the Commission's staff may extend any of the procedural dates set forth above.

IV.

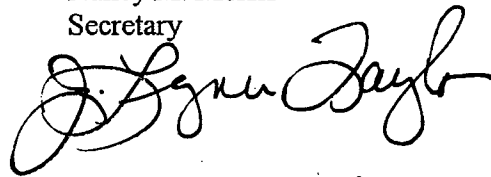
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent FBR's Offer.

Accordingly, pursuant to Section 15(b)(4) of the Exchange Act, it is hereby ORDERED that:

- A. FBR is censured; and
- B. FBR shall comply with the undertakings enumerated in Section III above.

By the Commission.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
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 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 Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions as to Glenn E. Glasshagel ("Order"), as set forth below.

### III.

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

1. Glasshagel, age 60, was a certified public accountant licensed to practice in the States of California and Illinois until 2001. Glasshagel served as Chief Financial Officer, Principal Financial Officer and Principal Accounting Officer of Roadhouse Grill, Inc. ("Roadhouse") from 1998 until he resigned during approximately July 2000.

2. Roadhouse, a Florida corporation with its corporate headquarters in Pompano Beach, Florida, is a restaurant chain. At all relevant times, Roadhouse was an issuer subject to the reporting requirements of Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Roadhouse was listed on the NASDAQ National Market from November 1996 until July 2001, when NASDAQ halted quotations in Roadhouse's stock after the company delayed the filing of its Form 10-K for the fiscal year ended April 29, 2001. In May 2002, Roadhouse was delisted from NASDAQ.

3. On July 15, 2005, the Commission filed a complaint against Glasshagel in the United States District Court, Southern District of Florida. [SEC v. Glenn E. Glasshagel, Civil Action No. 05-61159-Cooke]. On October 31, 2006, the court entered an order permanently enjoining Glasshagel, by consent, from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. The Court also barred Glasshagel from serving as an officer or director pursuant to Section 21(d)(2) of the Exchange Act.

4. The Commission's complaint alleged, among other things, that from at least 1999 through 2000, Glasshagel violated the federal securities laws when he fraudulently manipulated Roadhouse's income by (1) making improper adjustments to the company's expense accounts and (2) recognizing fictitious revenue. Glasshagel's financial chicanery violated Generally Accepted Accounting Principles and materially misrepresented Roadhouse's net income in financial statements filed with the Commission during fiscal years 1999 and 2000. This overstatement of net income allowed Roadhouse to meet or exceed an outside analyst's estimates. As a result of Glasshagel's misconduct, Roadhouse overstated its net income by at least 5% for the fiscal year ended April 25, 1999, and by approximately 35% for the fiscal year ended April 30, 2000.

IV.

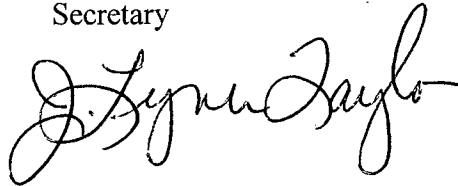
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Glasshagel's Offer.

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

A. Respondent Glasshagel is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

Commissioner Atkins  
Not Participating

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 55107 / January 16, 2007

INVESTMENT ADVISERS ACT OF 1940  
Rel. No. 2579 / January 16, 2007

Admin. Proc. File No. 3-11536

In the Matter of  
  
JOSE P. ZOLLINO

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Conviction

Injunction

Former associated person of registered broker-dealer and investment adviser was convicted and permanently enjoined from violating antifraud provisions of the federal securities laws. Held, it is in the public interest to bar Respondent from association with any broker, dealer, or investment adviser.

APPEARANCES:

Jose P. Zollino, pro se.

J. Kevin Edmundson, for the Division of Enforcement.

Appeal filed: April 10, 2006  
Last brief received: July 17, 2006

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## I.

Jose P. Zollino, the former chairman of InverWorld, Inc. ("IW Advisers"), an investment adviser formerly registered with the Commission, and InverWorld Securities, Inc. ("IW Securities"), a broker-dealer formerly registered with the Commission, appeals from a decision of an administrative law judge. The law judge barred Zollino from association with any broker, dealer, or investment adviser based on Zollino's conviction for conspiracy to commit fraud and money laundering and on his injunction from violations of the antifraud provisions of the federal securities laws. The law judge's action followed our earlier remand to her of this matter based on procedural deficiencies we had identified in the proceedings below. <sup>1/</sup> To the extent we make findings, we base them on an independent review of the record, except with respect to those findings not challenged on appeal.

## II.

This administrative proceeding is based on criminal and injunctive proceedings brought against Zollino beginning in 1999. On August 4, 1999, we filed an emergency civil injunctive action in the United States District Court for the Western District of Texas against Zollino and several companies under his control, including IW Advisers and IW Securities and two off-shore affiliates, IG Services, Ltd. and IWG Services, Ltd. (collectively the "IW Affiliates"), all of which operated from IW Advisers' offices in San Antonio, Texas. According to the complaint, Zollino owned, through a holding company, all of the stock of IW Advisers and IW Securities, and was the beneficiary of a trust that owned IG Services, Ltd. and IWG Services, Ltd.

The complaint alleged that, in early 1997, approximately 1,000 Latin American investors had invested over \$470 million with IW Advisers with directions that the funds be placed in low-risk or "conservative" investments that offered a fixed rate of return, such as certificates of deposit and U.S. Treasury obligations. Instead, according to the complaint, IW Advisers, without the investors' knowledge, directed a substantial portion of the invested funds into "highly leveraged, speculative investments, such as volatile emerging market investments . . . and for other improper and unauthorized purposes." The complaint alleged that this deviation from clients' investment directives was concealed by IW Advisers' fraudulent monthly account statements, which failed accurately to disclose how investor funds were invested and the risks associated with these investments. The complaint asserted that investors were instructed to wire funds to bank accounts in the United States and that some investors personally delivered funds to IW Advisers' offices in San Antonio, Texas. On June 25, 1999, IW Advisers announced that it was unable to permit client withdrawals because of "severe financial setbacks in connection with its emerging markets and other investments." Since that time, IW Advisers' clients have been unable to withdraw funds from their accounts. The complaint further alleged that Zollino, among others, "control[led] and direct[ed]" the activities of the IW Affiliates and was aware that client

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<sup>1/</sup> Jose P. Zollino, Investment Advisers Act Rel. No. 2381 (Apr. 29, 2005), 85 SEC Docket 1292.

funds were used for improper purposes and that the values of client investments were not accurately disclosed.

On August 4, 1999, the court granted the emergency relief that had been requested by freezing the assets of IW Advisers and appointing a receiver to oversee those assets. The injunctive action was then stayed pending resolution of related criminal charges against Zollino. The related criminal proceeding was resolved when Zollino agreed to plead guilty to conspiracy to commit fraud in violation of 18 U.S.C. § 371 and conspiracy to launder monetary instruments in violation of 18 U.S.C. § 1956. 2/

On May 15, 2002, at the hearing where Zollino entered his guilty plea, the judge asked the Assistant United States Attorney prosecuting the case to provide a "factual basis" for the government's case against Zollino. The Assistant United States Attorney stated, in response, that, if the case were to proceed to trial, the government would prove that Zollino "operated and controlled a group of companies, referred to as the InverWorld Group," that engaged in the business of investment advice and management, from offices located in San Antonio. According to the government, the IW Affiliates, among other abusive practices, accepted funds from customers to purchase securities that were never purchased and misled customers regarding their ownership of such securities with fraudulent account statements; they also used securities purchased for clients, and purportedly held in client accounts, as collateral for loans to the IW Affiliates. The government further asserted that the IW Affiliates, with the "knowledge, approval and direction of" Zollino, engaged in a series of "circular financial transactions, designed to conceal the true financial condition of the InverWorld Group from its auditors, clients, and counterparties," i.e., banks and other financial institutions with which the IW Affiliates did business. The government estimated investor losses at a "ballpark figure" of \$325 million. Although Zollino challenged the exact amount of investor losses, he acknowledged to the court that "the government could prove the facts alleged in their factual basis." 3/ On

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2/ U.S. v. Zollino, SA-01-CR-160-(1)-EP (W.D. Tex. Oct. 28, 2002).

3/ During Zollino's plea hearing, Zollino was asked whether he understood that he was pleading guilty to "conspiracy to commit fraud and conspiracy to launder monetary instruments." Zollino responded that he did. Zollino was then asked whether he pleaded guilty or not guilty to the charge of conspiracy to commit fraud and he answered "[g]uilty." He was then asked whether he pleaded guilty or not guilty to the charge of conspiracy to launder monetary instruments and he again answered "[g]uilty." At the same hearing, Zollino's attorney later stated that, while Zollino "does not agree with all the facts recited by [the Assistant U.S. Attorney], while he is not aware of some others, Mr. Zollino is prepared to stipulate and agree under oath that the government could prove the facts alleged in their factual basis." In explaining the factual assertions to which Zollino took exception, Zollino's attorney explained that his client disputed the amount of the losses claimed by the prosecution. The judge then asked Zollino whether he was

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October 28, 2002, Zollino was sentenced to 144 months imprisonment and ordered to pay restitution of \$341,787,496. 4/ The record indicates that Zollino is currently incarcerated.

After Zollino's sentencing in the criminal proceeding, the Division moved for partial summary judgment in the civil enforcement proceeding that had been pending, and requested entry of an injunction. 5/ On January 7, 2004, the court granted the Division's motion, 6/ and enjoined Zollino from violating the antifraud provisions of the Securities Act of 1933, 7/ the Securities Exchange Act of 1934, 8/ and the Investment Advisers Act of 1940. 9/

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3/ (...continued)

admitting to the government's factual recitation, with the caveat about the disputed amount of losses. Zollino responded that "with that [, the amount of the loss,] notation, yes, sir."

4/ According to Zollino, and notwithstanding his guilty plea and acknowledgment that the government could prove the allegations against him, he is appealing the conviction. It is unclear from the record what the basis is for Zollino's appeal or its current status. We note that Zollino had challenged the conviction based on his claim that he had ineffective assistance of counsel, but that such claim was rejected by the district court. Zollino v. U.S., Nos. SA-03-CA-0986-XR, SA-01-CR-180, 2004 WL 692154 (W.D. Tex. Mar. 29, 2004). We further note that Zollino appealed the denial of two post-judgment motions challenging the validity of his restitution order, his "Writ of Error to Correct Judgment," and his motion to vacate the district court's "Orders of Issuance of Writ of Garnishment, where no Restitution Order [was] Valid or Outstanding," and that this appeal was dismissed. U.S. v. Zollino, Nos. 03-51250, 04-50106, 2005 WL 1993790 (5th Cir. Aug. 18, 2005). The Division represented in its brief that it is "not aware that any aspect of Zollino's criminal proceeding is currently under appeal," and Zollino does not substantiate his claim of a pending appeal. However, even if Zollino is currently appealing his conviction, "the pendency of an appeal does not preclude us from acting to protect the public interest." Joseph P. Galluzzi, 55 S.E.C. 1110, 1116 n.21 (2002).

5/ The record contains the complaint that had been filed in the injunctive action, but does not include the motion for partial summary judgment or documents that had been filed in support of, or in opposition to, the motion, if any.

6/ SEC v. InverWorld, Inc., Civil Action No. SA-99-CA-0822 (FB) (W.D. Tex. Jan. 7, 2004).

7/ 15 U.S.C. § 77q(a).

8/ 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5.

9/ 15 U.S.C. § 80b-6.

On July 7, 2004, this administrative proceeding was instituted to determine the extent to which Zollino should be subject to remedial action based on his criminal conviction and injunction. On September 23, 2004, the law judge issued an initial decision barring Zollino from association with any broker, dealer, or investment adviser. <sup>10/</sup> Zollino appealed the law judge's decision and, on April 29, 2005, we remanded the proceeding back to the law judge for further consideration based on the limited amount of time Zollino had been given to review the Division's investigative file and the law judge's failure to hold a prehearing conference. <sup>11/</sup> On remand, the law judge held a prehearing conference at which Zollino confirmed that he had been able to complete his review of the investigative file. Zollino also introduced sixteen exhibits, which the law judge admitted. <sup>12/</sup> On March 2, 2006, the law judge, finding that there was no genuine issue with regard to any material fact, granted the Division's Motion for Summary Disposition and issued a supplemental initial decision, again barring Zollino from association with any broker, dealer, or investment adviser. <sup>13/</sup> The law judge found that Zollino's conduct caused enormous losses, was "recurring and egregious," and evidenced a "high degree of scienter." Moreover, the law judge found that, despite his guilty plea, Zollino refused to acknowledge wrongdoing and sought to relitigate the basis for his conviction and injunction. The law judge noted that, while Zollino was given an opportunity to present mitigative evidence, he failed to do so except to claim that future violations were unlikely because IW Advisers and IW Securities have been liquidated. Further noting that Zollino had worked in the securities industry for many years before his incarceration, the law judge concluded that a bar was necessary to prevent him from "reenter[ing] his previous occupation when he regains his freedom."

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<sup>10/</sup> Jose P. Zollino, Initial Decision Rel. No. 258 (Sept. 23, 2004), 83 SEC Docket 3058.

<sup>11/</sup> See supra note 1.

<sup>12/</sup> Zollino seeks to "resubmit[]" all issues specified in these [earlier] briefs and petitions" that he had filed with the law judge. Under Rule 411(d) of our Rules of Practice, 17 C.F.R. § 201.411(d), our review of a law judge's initial decision "shall be limited to the issues specified in the petition for review or the issues, if any, specified in the briefing schedule order . . . ." See Sandra K. Simpson, 55 S.E.C. 766, 797 n.50 (2002) (declining to consider issue that had not been raised in the petition for review). Moreover, Zollino's effort to incorporate these prior filings would appear to violate our requirement, under Rule 450(c) of our Rules of Practice, that "opening . . . briefs shall not exceed 14,000 words," which include the number of words contained in pleadings incorporated by reference. 17 C.F.R. § 201.450(c). We have, accordingly, limited our review to the issues raised in Zollino's petition for review, and his opening and reply briefs, without reference to any additional issues he may have raised in his filings before the law judge.

<sup>13/</sup> Jose P. Zollino, Initial Decision Rel. No. 308 (Mar. 2, 2006), 87 SEC Docket 1651.

## III.

## A.

Under Exchange Act Sections 15(b)(4) and (6) <sup>14/</sup> and Advisers Act Sections 203(e) and (f), <sup>15/</sup> we may impose sanctions on a person associated with a broker, dealer, or investment adviser, consistent with the public interest, if, among other things, the associated person (a) has been convicted of a crime within the past ten years that involves the purchase or sale of securities, or that arose out of the conduct of the broker-dealer or investment adviser; or (b) has been permanently enjoined from engaging in any conduct or practice in connection with the purchase or sale of securities. The record establishes that the statutory basis for imposing remedial sanctions has been met here because of Zollino's associational status with IW Advisers and IW Securities and his conviction and injunction.

1. Although he does not deny his association with those firms or that he has been convicted and enjoined, Zollino argues that we nevertheless lack jurisdiction to impose remedial sanctions because, he claims, all of the conduct that formed the basis for his conviction and injunction involved "foreign entities that sold products and securities, issued monthly client statements and maintained a base of clients, none of which . . . were U.S. citizens or residents, and none of which took place within the U.S.A." <sup>16/</sup> The record does not support Zollino's claim that the misconduct that formed the basis for the criminal and injunctive proceedings occurred entirely outside the United States and did not implicate federal securities laws. <sup>17/</sup> As part of

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<sup>14/</sup> 15 U.S.C. §§ 78o(b)(4) and (6).

<sup>15/</sup> 15 U.S.C. §§ 80b-3(e) and (f).

<sup>16/</sup> Zollino also complains that the law judge and the Division have blurred the distinction between InverWorld entities based in the United States, which he admittedly controlled and which, he claims, did nothing wrong, and "other non-U.S. entities," which he asserts he did not "control[] or own." According to Zollino, the two groups of companies are "linked only by limited service contract agreements [and] should not be grouped together to imply that the alleged wrongdoing took place in the U.S. and was directed by Zollino." The district court, however, entered summary judgment based on allegations that Zollino controlled and directed both the foreign and domestic InverWorld entities that were involved in the fraudulent scheme, and that he had financial interests in them. Zollino's admissions in the criminal proceeding were not inconsistent with these allegations.

<sup>17/</sup> Zollino faults the law judge for stating in a footnote that Exchange Act Section 15(b)(4)(B) and Advisers Act Section 203(e)(2) provide that "a bar against association with a broker-dealer or investment adviser in the United States can be based on a conviction in a foreign court of a 'substantially equivalent crime' as those listed in those

(continued...)

Zollino's criminal prosecution, the Assistant United States Attorney asserted, and Zollino admitted the government could prove, among other things, that Zollino directed the IW Affiliates' fraudulent activities from offices in San Antonio, Texas. Moreover, the injunctive complaint alleged that, as part of the fraudulent scheme, investors wired funds to bank accounts in the United States and deposited funds at IW Advisers' Texas offices. The court granted the Division's motion for summary judgment in the injunctive proceeding and, under the Federal Rules of Civil Procedure, such a motion shall be granted only when the court finds that "there is no genuine issue as to any material fact" and "the moving party is entitled to a judgment as a matter of law." <sup>18/</sup> Based on Zollino's admissions and on the court's summary judgment in favor of the Division, we believe that it is appropriate to consider the allegations made against Zollino, including those that relate to the domestic aspects of the fraud, as true.

In any event, our authority to impose sanctions under the relevant Exchange Act and Advisers Act provisions is not limited as Zollino argues. Those provisions, as indicated, authorize us to impose sanctions against an individual who was associated with a broker, dealer, or investment adviser and who was convicted and/or enjoined in connection with the purchase or sale of securities. It is undisputed that Zollino satisfies these statutory requirements and that our jurisdiction, therefore, is clear.

2. Zollino further seeks to challenge this proceeding by contesting the factual basis for the underlying criminal and injunctive proceedings. He claims that "there is no evidence of fraud, material misrepresentations or omissions by him or participation in unlawful activities or evidence of his diverting client funds." According to Zollino, "if this proceeding was to rely solely on a previous conviction, such consideration is not contemplated by any of the Rules and Regulations of the Commission . . . [and] is, in essence unlawful and unconstitutional." <sup>19/</sup>

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<sup>17/</sup> (...continued)

sections." Zollino argues that the law judge's statement shows that she recognized "that no Securities laws were violated in the United States" and that she "stretches her reach and discretion by implying that in the particular case, a bar is based on a conviction in a foreign court" (emphasis added). This argument is without merit. The law judge accurately stated the law. Contrary to Zollino's assertion, the law judge did not state or imply that no securities laws were violated in the United States or that Zollino's bar was based on a conviction in a foreign court.

<sup>18/</sup> Fed. R. Civ. P. 56(c).

<sup>19/</sup> Zollino criticizes the law judge for having the "audacity to state that Zollino's actions were recurring and egregious, that Zollino acted with high degree of scienter, and that Zollino had not fully acknowledged the wrongful nature of his conduct." As discussed herein, we find no basis for disputing the law judge's assessment on all of these points.

Zollino's argument betrays a misunderstanding of the basis for, and purpose of, this proceeding. The basis for this proceeding is the action of the district court -- in convicting and enjoining him -- and its purpose is not to revisit the factual basis for that action 20/ but, rather, to determine what remedial sanctions, if any, should be imposed in the public interest. Indeed, and contrary to Zollino's assertion, Exchange Act Section 15(b) expressly authorizes us to impose remedial sanctions based on either a criminal conviction or an injunction where, as here, they involved activities related, among other things, to the purchase or sale of securities. 21/ Moreover, as discussed, we consider it appropriate to consider the allegations made in the criminal and injunctive proceedings as true, based on Zollino's admissions and on the district court's grant of summary judgment.

B.

1. Zollino raises various procedural objections to the law judge's handling of the case. Zollino complains that, by precluding him from disputing the merits of the underlying court proceedings, the law judge "foreclose[d him] from arguing and presenting mitigating evidence." While Zollino may not challenge the allegations that provide the basis for the court action, he was free to introduce evidence regarding the "circumstances surrounding" those allegations as

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20/ It is well established that "a party cannot challenge his injunction or criminal conviction in a subsequent administrative proceeding." Galluzzi, 55 S.E.C. at 1115-16. See also Charles Trento, Securities Exchange Act Rel. No. 49296 (Feb. 23, 2004), 82 SEC Docket 785, 789-90 (noting that "it is well established that a respondent may not collaterally attack his criminal conviction in administrative proceedings before this Commission"); Ira William Scott, 53 S.E.C. 862, 866 (1998) ("[a] criminal conviction cannot be collaterally attacked in an administrative proceeding"); Demetrios Julios Shiva, 52 S.E.C. 1247, 1249 (1997) (rejecting attempts to challenge basis for injunction and noting that "we have long refused to permit a respondent to re-litigate issues that were addressed in a previous civil proceeding against the respondent"). To the extent that Zollino wishes to challenge the basis of the prior proceedings, "those matters properly are addressed to the appellate court." Michael Batterman, Investment Advisers Act Rel. No. 2334 (Dec. 3, 2004), 84 SEC Docket 1349, 1356. As indicated, it does not appear that Zollino has done so. See supra note 4.

21/ As we have held, in a disciplinary proceeding under Exchange Act Section 15(b), "it is only necessary that evidence be adduced with respect to grounds for remedial action that are specified in Section 15(b)(6) . . . . While additional evidence relating solely to the issue of sanctions may be adduced, such evidence is not required for a determination of that issue under Section 15(b)(6)." Bruce Paul, 48 S.E.C. 126, 127 (1985).

means of addressing "whether sanctions should be imposed in the public interest." 22/ Although the law judge properly rejected Zollino's effort to challenge the underlying criminal and injunctive proceedings, her doing so in no way precluded Zollino from introducing evidence related to the determination of an appropriate sanction. Indeed, both the law judge and our earlier opinion informed Zollino that he could present evidence of mitigative factors, 23/ and Zollino concedes that he was accorded this opportunity. 24/ However, even though he was aware of this opportunity, Zollino largely failed to take advantage of it.

To support his claim of mitigating circumstances, Zollino introduced affidavits from persons who were familiar with the operations of the IW Affiliates or who invested with these entities. These affidavits purport to support his contention that he did not engage in the misconduct that formed the basis for the underlying district court proceedings. 25/ As we

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22/ Schild Management Company, Exchange Act. Rel. No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 859-60 (quoting Blinder, Robinson & Co., Inc. v. SEC, 837 F.2d 1099, 1109 (D.C. Cir. 1988)).

23/ In our original opinion, we expressly directed that, "in addition to holding a prehearing conference, the law judge should determine on remand whether Zollino has now had a reasonable opportunity to review the Investigative File and whether Zollino should be permitted to present mitigative evidence and additional arguments in response to the Division's motion for summary disposition." Zollino, 85 SEC Docket at 1296-97. In response to our directive, the law judge informed Zollino at the prehearing conference that he had the opportunity to present additional arguments, and she granted him the time that he requested to prepare his filing.

24/ Zollino notes in his brief that we had "originally remanded the proceeding . . . to allow him to present mitigative evidence and additional arguments, which [he] complied with painstakingly and at length, offering not only substantial evidence, but arguments and authorities that support [his] defense." As discussed below, we do not believe that Zollino has presented mitigative evidence to support a sanction less than a bar.

25/ For example, Zollino submitted the declaration of Ignacio Negrete Perales, a former chief executive officer and managing director of Corporacion Asesora Internacional, S.A. de C.V. ("CAI"). CAI was a Mexican investment services company that offered its clients, among other products, securities issued by an affiliate of IW Advisers. Mr. Perales stated that his company's advisers did not take instructions from Zollino, IW Advisers, or any other affiliated entity, and CAI's advisers were not required to use the services or purchase investments from, or through, these entities. Zollino also submitted the declarations of several non-U.S. investors who had purchased securities through IW Securities and other affiliated entities and who stated that they were satisfied with their investments and were never told that the securities they purchased were risk free.

explained above, Zollino may not challenge his criminal conviction or injunction here. 26/ To the extent that the affidavits address the public interest factors relevant to a determination of the appropriate sanction, they are considered and discussed below.

2. Zollino also faults the law judge for not having reviewed the Division's investigative file before issuing her Supplemental Initial Decision and argues that this "showed insufficient due process." We do not believe that the law judge had an obligation to review the investigative file or that Zollino, for this or any other reason, was denied due process. Our Rules of Practice provide only that a respondent be provided access to the Division's investigative file. 27/ The burden is on the respondent to review the file and seek to introduce anything from the file that supports his or her arguments on appeal. 28/ Contrary to Zollino's assertion, there is no requirement that the law judge review the contents of an investigative file.

Zollino also criticizes the law judge for holding only a prehearing conference, and not a full hearing, which, according to Zollino, "would [have] otherwise [brought] the facts and afford[ed] justice and due process to a citizen of the United States." The law judge did not hold a hearing in this matter because she had granted the Division's motion for summary disposition after finding, as required by Rule of Practice 250(b), 29/ that there was no genuine issue with regard to any material fact in the case. We find that the law judge acted properly in granting summary disposition. Our rules do not mandate the holding of an evidentiary hearing.

#### IV.

We now turn to a determination of whether the public interest requires the imposition of sanctions against Zollino. Zollino claims that "there is not sufficient evidence to establish facts which provide a basis for a permanent bar." In determining the appropriate sanction to impose on Zollino, we are guided by the following factors:

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26/ See supra note 20.

27/ Rule of Practice 230(a)(1) provides that "the Division of Enforcement shall make available for inspection and copying by any party documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division's recommendation to institute proceedings." 17 C.F.R. § 201.230(a)(1).

28/ During the prehearing conference, in which Zollino fully participated, he confirmed that he had reviewed the investigative file.

29/ Rule of Practice 250(b) provides that a hearing officer 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).

[T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations. 30/

This requires that we "address[] the nature of the violation and the mitigating factors presented in the record." 31/ In making this determination, "we recognize that conduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions under the securities laws." 32/ Based on a consideration of the relevant factors, and all of the circumstances in this case, we believe that the public interest requires that Zollino be barred.

Zollino played a pivotal role in a massive fraudulent scheme. That scheme, which extended over a two-year period, resulted in staggering investor losses. As a result of his misconduct, Zollino was criminally convicted of conspiracy to commit fraud and conspiracy to launder monetary instruments, ordered to pay approximately \$342 million in restitution, and enjoined from violating the antifraud provisions of the federal securities laws. Zollino's misconduct was both egregious and recurring, and evidences a high degree of scienter.

Throughout these proceedings, Zollino has shown no recognition of the wrongful nature of his conduct, nor has he shown any remorse. He has also provided no assurance against future violations. Zollino's failure to acknowledge guilt or show remorse indicates that there is a significant risk that, given the opportunity, Zollino would commit further misconduct in the future. 33/ We are not persuaded by Zollino's claim that he is unlikely to engage in future misconduct because IW Advisers and IW Securities have been liquidated. Absent a bar and after he has served his prison sentence, he could seek to reenter the securities industry through an association with another broker, dealer, or investment adviser.

We have held repeatedly that, absent "extraordinary mitigating circumstances," an individual who has been criminally convicted in connection with activities related to the purchase

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30/ Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979); aff'd on other grounds, 450 U.S. 91 (1981).

31/ McCarthy v. SEC, 406 F.3d 179, 190 (2d Cir. 2005).

32/ Marshall E. Melton, Investment Advisers Act Rel. No. 2151 (July 25, 2003), 80 SEC Docket 2812, 2825.

33/ Indeed, as noted, Zollino continues to insist that "[t]here is no evidence of fraud, material misrepresentations or omissions by him or participation in unlawful activities or evidence of his diverting client funds . . . ."

or sale of securities cannot be permitted to remain in the securities industry. 34/ There are no such circumstances here. Zollino's purported mitigative evidence, contained in written statements by former investors in, and various other persons connected to, the IW Affiliates, 35/ seek to challenge the basis for the district court proceeding. As discussed, he is precluded from making such a challenge in this proceeding. To the extent that these statements seek to minimize the seriousness of Zollino's misconduct, we believe that the record compels a contrary conclusion and demonstrates Zollino's unfitness to remain in the securities industry.

In our view, Zollino's actions constituted "an egregious abuse of the trust placed in him as a securities professional." 36/ By engaging in the misconduct that provided the basis for his criminal conviction and injunction, Zollino "demonstrated a complete disregard for the fundamental standards of honesty and fair dealing that govern those who are employed in the securities industry." 37/ We believe that, based on his prior actions, he represents a significant risk to the public and should be prevented from acting as a securities professional in the future. Accordingly, we have determined to bar Zollino.

An appropriate order will issue. 38/

By the Commission (Chairman COX and Commissioners CAMPOS, NAZARETH, and CASEY); Commissioner ATKINS not participating.

Nancy M. Morris

Secretary

*J. Lynn Taylor*  
By: J. Lynn Taylor  
Assistant Secretary

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34/ Frederick W. Wall, Exchange Act Rel. No. 52467 (Sept. 19, 2005), 86 SEC Docket 857, 863. See also Melton, 80 SEC Docket at 2825-26 (holding that, "ordinarily, and in the absence of evidence to the contrary, it will be in the public interest to . . . bar from participation in the securities industry . . . a respondent who is enjoined from violating the antifraud provisions [of the federal securities laws]").

35/ See supra note 25.

36/ John S. Brownson, 55 S.E.C. 1023, 1029 (2002) (respondent barred based on his conviction for conspiracy to commit securities fraud).

37/ Wall, 86 SEC Docket at 863 (respondent barred based on conviction for securities fraud).

38/ 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. 55107 / January 16, 2007

INVESTMENT ADVISERS ACT OF 1940  
Rel. No. 2579 / January 16, 2007

Admin. Proc. File No. 3-11536

In the Matter of  
  
JOSE P. ZOLLINO

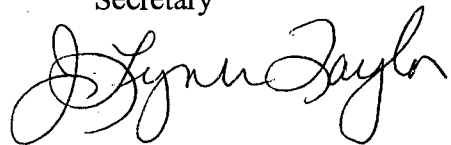
ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Jose P. Zollino be, and he hereby is, barred from association with any broker, dealer, or investment adviser.

By the Commission.

Nancy M. Morris  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
January 17, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12539

In the Matter of

Capmacco Corp.  
First CMA, Inc.  
McCarthy Grenache, Inc., and  
National CMA, 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").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Capmacco Corp. (CIK No. 1071753) is a dissolved Colorado corporation located in Boulder, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Capmacco Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of \$3,183 for the prior nine months.

2. First CMA, Inc. (CIK No. 1071757) is a dissolved Colorado corporation located in Boulder, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). First CMA, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$2,346 for the prior nine months.

3. McCarthy Grenache, Inc. (CIK No. 1098811) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of equity securities registered with

Document 29 of 54

the Commission pursuant to Exchange Act Section 12(g). McCarthy Grenache, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2004, which reported a net loss of \$45,582 for the prior nine months.

4. National CMA, Inc. (CIK No. 1021773) is a dissolved Colorado corporation located in Boulder, Colorado with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). National CMA, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$2,494 for the prior nine months.

#### B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), 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. Moreover all of the respondents at various times, through their officers, directors, or consultants had a connection with National CMA, Inc.

6. 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 (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

7. As a result of the foregoing, Respondents 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 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 of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

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 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 each Respondent personally, by certified or express mail, or by any other means permitted by the Commission's 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.

Attachment

Nancy M. Morris  
Secretary

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

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 55118 / January 18, 2007

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 2580 / January 18, 2007

**INVESTMENT COMPANY ACT OF 1940**  
Release No. 27663 / January 18, 2007

**ADMINISTRATIVE PROCEEDING**  
File No. 3-12540

**In the Matter of**

**FRED ALGER  
MANAGEMENT, INC. AND  
FRED ALGER & COMPANY,  
INCORPORATED,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF 1940, and  
SECTIONS 9(b) AND 9(f) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**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"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Fred Alger Management, Inc. ("Alger Management") and Fred Alger & Company, Incorporated ("Alger Inc.") (collectively the "Respondents" or "Alger").

## 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

## III.

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

### A. SUMMARY

1. This matter involves market timing and late trading of mutual funds in the Alger Fund Group (including the "Alger Fund"). Alger Management, the investment adviser to mutual funds in the Alger Fund Group, and Alger Inc., a broker-dealer that serves as the principal underwriter and distributor of Alger Fund Group mutual funds, permitted numerous select investors to market time the Alger Fund. This timing activity contradicted representations in the Alger Fund's prospectus that limited shareholders to six exchanges a year. Additionally, Alger Management failed to disclose that Alger Inc. had entered into numerous arrangements with select investors, including "sticky asset" arrangements, to permit them to time the Alger Fund.

2. More specifically, from at least 2000 through late 2002, Alger Inc. permitted select investors to time the Alger Fund. Over time, Alger Inc. also began to demand that market timers place "static" or "buy and hold" investments in certain portfolios within the Alger Fund in exchange for timing capacity (these arrangements are sometimes referred to as "sticky asset" arrangements). In early 2003, Alger Inc. formalized this practice by requiring sales employees to negotiate a buy and hold investment equal to twenty percent of an investor's funds within the Alger Fund Group mutual fund complex in return for new timing capacity. Alger Inc.'s sales force then negotiated a number of these arrangements with market timers.

3. Alger Inc. permitted one hedge fund customer, Veras Investment Partners ("Veras"), to engage in late trading of Alger Fund portfolios.

4. The market timing in the Alger Fund diluted the value of long-term shareholders' investments. At the same time, Alger Inc. and Alger Management benefited through advisory fees paid to Alger Management and distribution and servicing fees paid to Alger Inc.

## **B. RESPONDENTS**

5. **Alger Management** is a registered investment adviser located in New York, New York. Alger Management is a wholly-owned subsidiary of Alger Inc. Alger Management serves as the manager for portfolios within the Alger Fund Group mutual fund complex including the Alger Fund, the Alger American Fund, the Alger Institutional Fund, and the Spectra Fund. As of December 31, 2005, Alger Management managed assets of approximately \$9.4 billion within the Alger Fund Group. Alger Management is an affiliate of the Alger Fund, a registered investment company.

6. **Alger Inc.** is a registered broker-dealer. Alger Inc. is a wholly-owned subsidiary of Alger Associates, Inc., a privately-held financial services holding company. Alger Inc. is the parent of Alger Management. Alger Inc. serves as the principal underwriter and distributor for mutual funds in the Alger Fund Group. Alger Inc. is an affiliate of the Alger Fund, a registered investment company.

## **C. RELEVANT PERSON AND ENTITIES**

7. **Alger Fund Group** consists of several mutual funds advised by Alger Management. The primary products within the Alger Fund Group are the Alger Fund (the retail product), the Alger American Fund (the insurance and retirement product), and the Alger Institutional Fund (the institutional investor-oriented fund). In addition, Alger Management serves as the investment adviser to the Spectra Fund, a mutual fund which seeks long-term capital appreciation by investing in growth stocks.

8. **The Alger Fund** was a diversified, open-end registered investment company organized as a business trust under the laws of the Commonwealth of Massachusetts during the relevant period. The Alger Fund operated as a series company that issued shares in eight portfolios: LargeCap Growth, SmallCap Growth, Balanced, MidCap Growth, Capital Appreciation (or CapApp), Health Sciences, SmallCap and MidCap Growth, and Money Market. Each of the portfolios within the Alger Fund was operated as if it were a separate mutual fund. Beginning in February 2004, the name of the Alger Fund was changed to "The Alger Funds." For simplicity, this Order refers to the Alger Fund.

9. **James P. Connelly, Jr.**, a resident of New Jersey, served as an Executive Vice President of Alger Inc. Connelly was the Vice Chairman of the Board of the Alger Fund from 2001 to 2003. Connelly served as a member of Alger's Office of the President during 2002. In October 2003, Connelly consented to an administrative and cease-and-desist order for his role in allowing customers to market time the Alger Fund in exchange for buy and hold investments. See In the Matter of James Patrick Connelly Jr., Admin. Proc. File No. 3-11303 (Oct. 16, 2003). Simultaneously, Connelly pled guilty to obstructing the New York Attorney General's and Commission's investigations in this matter. The People of the State of New York v. James P. Connelly Jr., SCI-5648/03 (N.Y. Sup. Ct. Oct. 16, 2003 and Dec. 17, 2003).

## **D. FACTS**

### **Market Timing and Late Trading of Mutual Funds**

10. Market timing includes: (i) frequent buying and selling of shares of the same mutual fund or (ii) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing can harm other mutual fund shareholders because it can dilute the value of their shares. Market timing, while not illegal per se, can also disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur considerable extra costs associated with excessive trading and, as a result, cause damage to other shareholders in the funds.

11. Rule 22c-1(a), as adopted under Section 22(c) of the Investment Company Act, requires registered investment companies issuing redeemable securities and principal underwriters, among others, to sell and redeem fund shares at a price based on the current net asset value, or NAV, next computed after receipt of an order to buy or redeem. Mutual funds generally determine the daily price of mutual fund shares as of 4:00 p.m. E.T. Mutual funds' prospectuses, such as the Alger Fund's prospectus, state that orders received before 4:00 p.m. are executed at the price determined as of 4:00 p.m. that day, and that orders received after 4:00 p.m. are executed at the price determined as of 4:00 p.m. the next trading day.

12. "Late trading" refers to the practice of placing orders to buy, redeem, or exchange mutual fund shares after the time as of which mutual funds calculate their NAVs, usually as of the close of trading at 4:00 p.m. E.T., but receiving the price based on the prior NAV already determined as of 4:00 p.m. Late trading enables the trader to profit from market events that occur after 4:00 p.m. but that are not reflected in that day's price. In particular, the late trader obtains an advantage – at the expense of the other shareholders of the mutual fund – when he learns of market moving information and is able to purchase (or redeem) mutual fund shares at prices set *before* the market moving information was released. Late trading violates Rule 22c-1(a), as adopted under Section 22(c) of the Investment Company Act, and harms other shareholders when late trading dilutes the value of their shares.

### **The Alger Fund Prospectuses Purported to Limit Frequent Trading**

13. The Alger Fund prospectuses indicated that the mutual funds were intended for long-term investors and that all investors would be limited to a certain number of exchanges per year.

14. The prospectuses for the Alger Fund in effect from 2001 through 2003 for each of its seven equity portfolios identified the investment goal as "long-term capital appreciation." Further, these Alger Fund prospectuses indicated that investors were permitted to make up to six exchanges per year, and indicated that Alger reserved the right to reject purchase orders. Specifically, the Alger Fund prospectuses incorporated the Statement of Additional Information ("SAI") into the prospectuses. The SAI to the February 28, 2003 Alger Fund prospectus contained the following disclosure:

## EXCHANGES AND CONVERSIONS

You may make up to six exchanges annually by telephone or in writing. The Fund may charge a transaction fee for each exchange, although it does not intend to do so at present. You will be notified at least 60 days in advance if the Fund decides to impose this fee. The Fund reserves the right to terminate or modify the exchange privilege upon notice to shareholders.

15. Further, prospectuses for the Alger Fund disclosed the fund's policy for enforcing Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act. The February 28, 2003 prospectus stated:

### NET ASSET VALUE

The price of one share is its "net asset value," or NAV, next determined after a purchase request is received in good order, plus any applicable sales charge. The NAV for each portfolio . . . is calculated as of the close of business (normally 4:00 p.m. Eastern time) every day the New York Stock Exchange is open.

....

### PURCHASING AND REDEEMING FUND SHARES

You can purchase or redeem shares on any day the New York Stock Exchange is open. They will be processed at the NAV next calculated after your purchase or redemption request is received in good order by the Transfer Agent. . . . The Transfer Agent or Fund may reject any purchase order.

16. The SAI to the Alger Fund's February 28, 2003 prospectus contained additional details about how the fund would process trades in accordance with Rule 22c-1. Specifically, the SAI stated:

The price of one share of a class is based on its "net asset value." . . . The net asset value is calculated as of the close of business (normally 4:00 p.m. Eastern time) . . . on each day the New York Stock Exchange ("NYSE") is open.

....

Purchases . . . will be based upon the next net asset value calculated for each class after your order is received and accepted. If your purchase is made by check, wire or exchange and is received by the close of business of the NYSE (normally 4:00 p.m. Eastern time), your account will be credited on the day of receipt.

If your purchase is received after such time, it will be credited the next business day.

17. The prospectuses for the Alger Fund in effect from 2000 through 2003 made untrue statements of material fact by stating that investors were limited to six annual exchanges and that purchases and redemptions would be processed at the NAV next calculated after such request was received. Moreover, the February 28, 2003 prospectus failed to disclose that Alger Inc. had instituted a buy and hold program through which select investors were able to market time certain Alger Fund portfolios in exchange for making a long-term investment in other portfolios.

18. Connelly, as Vice Chairman of the Board of the Alger Fund from 2001 to 2003 and a member of Alger's Office of the President during 2002, was aware that the Alger Fund prospectuses limited exchanges to six per year. In addition, in early 2003, several Alger, Inc. management employees formed a working group to review the Alger Fund prospectus language with respect to market timing.

**Alger Management and Alger Inc. Permitted  
Select Investors To Market Time Alger Fund Portfolios**

*Alger Management and Alger Inc. Permitted Market Timing*

19. Despite the statements in the Alger Fund prospectus, Alger Management and Alger Inc. permitted certain investors to market time the Alger Fund.

20. Connelly was generally aware of and approved allowing select investors to market time the Alger Fund. In early 2001, Connelly appointed the Director of Internal Wholesaling as Alger Inc.'s "timing police." The Director of Internal Wholesaling did not function, however, as the name "timing police" implied (i.e., to seek to identify market timers and to bar them from trading in Alger Fund Group mutual funds). Rather, the Director of Internal Wholesaling sought to keep track of the amount of approved market timing capacity within the Alger Fund, and only sought to bar market timers that had not negotiated timing capacity. Alger employees only invoked the six-exchange limit as a means to require timers to negotiate capacity.

21. Following the events of September 11, 2001, when Alger's offices in the World Trade Center were destroyed and numerous employees were lost, the Alger Fund Group's assets under management began to diminish, at least in part, because investors were concerned about its ability to continue in operation. Connelly, with input from others such as Alger Inc.'s National Sales Manager, decided to seek additional market timing assets as a means of increasing assets under management. Consequently, in October 2001, Connelly authorized an increase in timing capacity in the Alger Fund.

*Alger Inc. Instituted a Twenty Percent Buy and  
Hold Requirement In Exchange For Timing Capacity*

22. As Alger Inc. was seeking additional timing assets, investors seeking timing capacity often offered to make "buy and hold" investments in exchange for timing capacity.

Recognizing an opportunity, Connelly developed over time a de facto practice of asking timers to commit assets to buy and hold positions in exchange for timing capacity. The Director of Internal Wholesaling then regularly provided Connelly with updates about the flow of timing assets in the Alger Fund, as well as total timing assets and breakdowns identifying the portfolios in which timing assets were invested. As of November 30, 2002, there were at least thirty-three known market timers in the Alger Fund.

23. Near the end of 2002, Connelly decided to require that all market timers make a twenty percent buy and hold investment in exchange for timing capacity. Connelly then directed the Director of Internal Wholesaling to institute this policy beginning in January 2003. In mid-January 2003, the Director of Internal Wholesaling sent an e-mail to Alger Inc.'s wholesalers to implement the twenty percent buy and hold policy. She wrote that any timers who refused to comply with the "new [twenty percent buy and hold] policy" "will not be granted any additional space in the portfolios," and their accounts will "be monitored on a weekly basis and any unauthorized trades will be rejected."

24. Alger Inc. employees negotiated numerous buy and hold market timing arrangements. For example, in February 2003, an outside wholesaler negotiated an arrangement with Veras to allow it to make fifteen exchanges per quarter (or sixty exchanges per year). Veras agreed to make a \$10 million buy and hold investment in the Alger Fund SmallCap portfolio. In exchange, Connelly granted Veras \$50 million in timing capacity in other Alger Fund portfolios. In July 2003, Veras agreed to make an additional \$12 million buy and hold investment in exchange for an additional \$30 million of timing capacity. In fact, Veras made eighty-eight exchanges between February 2003 and August 2003.

*Alger Inc. Allowed Select Investors to Market Time the  
Alger Fund While Preventing Other Investors from Market Timing*

25. Alger Inc. prohibited certain investors from market timing the Alger Fund. For example, in June 2003, an Alger Inc. vice-president instructed a telemarketing representative in an email to respond to an inquiry from a potential investor that "we do not tolerate market timing." This statement was false.

26. In August 2003, Alger Inc. turned to the six-exchange limitation to prevent timers who had not made buy and hold investments from seeking to time the Alger Fund. The Director of Internal Wholesaling instructed the supervisors for the Alger Fund telemarketing staff to refer to the six-exchange limit to keep out unwanted timers. She wrote in an e-mail that "[i]n an ongoing effort to prevent new timers from entering the funds, I wanted to make sure your group was aware of the exchange limitation policy in our SAI."

*Alger Management Portfolio Managers  
Voiced Concerns About the Effects of Market Timing*

27. Alger Management was aware that investors were excessively market timing the mutual funds, including the Alger Fund.

28. Indeed, portfolio managers responsible for managing portfolios in Alger Fund Group mutual funds, including the Alger Fund and Alger American Fund (where timing also occurred), were aware that investors were timing their portfolios and they raised numerous concerns about the effects of market timing.

29. For example, a portfolio manager managed Alger Fund's SmallCap portfolio, as well as Alger American Fund's SmallCap portfolio, beginning in the Fall of 2001. Shortly after beginning managing these portfolios, the portfolio manager raised concerns about market timing with the Vice Chairman of Alger Inc., who was responsible for the distribution of the Alger American Fund (the "Vice Chairman"), as well as others at Alger Management and Alger Inc. The portfolio manager complained that excessive trading was disrupting her ability to manage the Alger American Fund's SmallCap portfolio. On December 28, 2001, the portfolio manager sent an e-mail to the Alger Inc. Vice Chairman, as well as Alger Management's Chief Investment Officer ("CIO"). In the e-mail, the portfolio manager stated:

Currently the [Alger American Fund SmallCap portfolio] is showing 14% cash while all the other funds [i.e., Alger Fund and Alger Institutional Fund SmallCap portfolios] have about 2 to 3 percent. . . . I have been spending a good deal of time just managing this cash issue while trying to keep the funds having similar holdings and similar performance. . . . Please help-this has become a large daily frustration which is hurting the performance of all the small cap funds. (emphasis added.)

In this December 28, 2001 email, the portfolio manager also stated that she had to purchase a significant amount of equity securities to avoid showing a large amount of cash on the fund's books for year-end 2001:

I am running a buy program today so that we don't show this cash position for year end but obviously if they take the funds out we will be overdrawn.

30. In November 2002, the SmallCap portfolio manager sent an e-mail to Connelly, the Alger Inc. Vice Chairman, and the Alger Management CIO indicating that market timing in the Alger American Fund Small Cap portfolio was "getting out of hand." In addition, the portfolio manager expressed her frustration with dealing with timers:

I have managed all year with market timers moving in and out of this fund; however recently the amount of funds has become close to 25 percent of the funds (sic) assets and the frequency of trades is such that I could not possibly respond to these money flows.

31. In December 2002, the SmallCap portfolio manager sent an e-mail to Connelly, the Alger Inc. Vice Chairman, and the CIO inquiring whether they were "comfortaqble (sic) with the fact I cannot respond to these inflows?"

32. In February 2003, an Alger Trustee was appointed the Managing Director for Alger

Management responsible for taking over day-to-day management of the Alger Fund Group mutual fund complex. The SmallCap portfolio manager immediately alerted the Managing Director to her concerns about the impact of market timing on the Alger American Fund SmallCap portfolio. Specifically, the portfolio manager indicated that the market timing transactions had caused a discrepancy between the performance of the SmallCap portfolio in the Alger American Fund and the other Alger SmallCap portfolios. She also indicated that the magnitude of market timing transactions prevented her from being able to buy and sell securities. Further, the portfolio manager voiced her opinion that timers were preventing her from carrying out her fiduciary duty. The Alger Inc. Vice Chairman, however, then noted that terminating market timing in the Alger American Fund would jeopardize Alger's relationships with variable annuity companies, whose contract holders were timing the Alger American Fund portfolios, and possibly result in the loss of millions of dollars in assets from the Alger Fund Group mutual fund complex.

33. Additionally, the Alger Management Capital Appreciation portfolio manager noticed timing flows and complained. In April 2003, the Capital Appreciation portfolio manager, as well as Alger Management's CIO co-authored an e-mail to Connelly and the Vice Chairman, with a copy sent to the Managing Director. The e-mail indicated that timers were "increasing their dollar amounts in cap app and mid cap. They're now 5% of cap app which is too high and having a negative impact on my running the fund." They asked whether the amount of timing assets could be reduced.

34. No one at Alger Management or Alger Inc. responded to the portfolio managers' complaints, and market timing in the Alger Fund (and the Alger American Fund) continued.

35. Neither Alger Inc. nor Alger Management disclosed to the Board of Trustees of the Alger Fund that Alger Inc. had entered into numerous arrangements, including "sticky asset" arrangements, with select investors to permit them to market time the Alger Fund.

*Portfolio Managers' Efforts to Deal with  
Market Timer Cash Flows Harmed Long-Term Investors*

36. Alger Management portfolio managers for the Alger Fund (and Alger American Fund) employed various tactics to deal with the harmful effects of market timers' cash flows.

37. For example, portfolio managers kept more assets in cash or cash equivalents than they otherwise would have in order to meet redemption requests by timers. On numerous occasions, portfolio managers then acquired significant amounts of equity securities at the end of a month or quarter to be able to show that the portfolios were fully invested (and not in cash or cash equivalents).

38. Further, portfolio managers drew down on lines of credit when they were not able to sell enough securities to deal with timer withdrawals. For example, in January 2002, Alger Management's CIO, who also managed the MidCap Fund, requested daily notification from the fund's back-office operations about timer transactions. In a January 2, 2002 e-mail making the request, the CIO noted that one portfolio had "13% of its assets go out today" and that he had

"almost entered in trades based on that that would have really screwed it up big time." In August 2002, the CIO sent an e-mail to the person in charge of Alger's back-office operations to inquire about withdrawals from the MidCap portfolio. The CIO noted that he felt "obligated to sell into this, as I have not ever had the fund that negative." The person in charge of back office operations responded to the CIO that "we have a line of credit to cover the overdraft." Eventually, the MidCap portfolio was forced to access the line of credit to deal with timers. For example, in May 2003, the MidCap portfolio drew down \$7.6 million on its line of credit.

### **Alger Inc. Approved an Arrangement to Permit a Hedge Fund to Engage in Late Trading**

39. Alger Inc. also approved late trading for one market timer.

40. In early 2003, an Alger Inc. wholesaler held a series of conversations with Veras' principals about timing Alger Fund portfolios. The Veras principals indicated that one of their requirements for investing in the Alger Fund was that they be permitted to enter trades after 4:00 p.m. Specifically, Veras' principals informed the Alger Inc. wholesaler that they needed until 4:30 p.m. to enter trades because their trading model was based on a "signal" from the close of the futures market (e.g., 4:15 p.m.). Thus, Veras' principals asked whether they could place orders to trade shares of Alger Fund portfolios after the futures market closed but still receive that day's NAV. The Alger Inc. wholesaler transmitted this request to Connelly. On February 21, 2003, the wholesaler sent an e-mail to Connelly indicating that Veras had "asked for a 4:30 cutoff and I said it wouldn't be a problem. Any problem?" Connelly replied "No." The wholesaler then sent an e-mail to Veras indicating that "[w]e got everything you wanted including a 4:30 cutoff." During the approximately six months the late trading arrangement was in effect, Veras executed trades after 4:00 p.m. E.T. on approximately eighteen occasions. In each instance, the late trades received that day's NAV.

### **The Government's Investigation Brought Market Timing and Late Trading at Alger to a Halt**

41. In the Fall of 2003, Alger Inc. moved to curtail the buy and hold program. On October 16, 2003, the day that Connelly was criminally charged and the Commission issued its Order as to him, Alger Management issued a public "letter to clients" in which it announced that, "[e]ffective immediately, we will not permit market timing in our funds." (emphasis in original.)

### **Alger Management and Alger Inc. Benefited From the Market Timing Arrangements While Investors Were Harmed**

42. Alger Management earned advisory fees from the mutual funds it managed, including the Alger Fund. Alger Inc. earned distributor fees on class B and C shares for the Alger Fund, as well as servicing fees on the Alger Fund.

43. At the same time, the market timing in the Alger Fund diluted the value of long-term shareholders' investments.

## VIOLATIONS

44. As a result of the conduct described above, Alger Management willfully violated, and Alger Inc. willfully aided and abetted and caused Alger Management's violations of, Sections 206(1) and 206(2) of the Advisers Act. Specifically, while acting as an investment adviser, Alger Management employed devices, schemes, or artifices to defraud clients or prospective clients, and engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon clients or prospective clients. Alger Management breached its fiduciary duty to the Alger Fund when it permitted harmful excessive trading contrary to the Alger Fund's prospectus disclosures without disclosing to the Board of Trustees that Alger, Inc. had entered into arrangements with select investors, including sticky asset arrangements, to permit them to time the Alger Fund. Alger Management also failed to disclose that in early 2003 Alger Inc. formalized this practice by requiring sales employees to negotiate a twenty percent buy and hold investment in return for new timing capacity. Finally, Alger Management failed to disclose that Alger Inc. permitted Veras to engage in late trading. By approving market timing arrangements and obtaining buy and hold investments in return for timing capacity, and failing to disclose these facts to the Board of Trustees, Alger Inc. aided and abetted and caused Alger Management's violations of Sections 206(1) and 206(2) of the Advisers Act.

45. As a result of the conduct described above, Alger Management and Alger Inc. willfully violated Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder, which prohibits affiliated persons of a registered investment company from participating in transactions in which an investment company is a joint participant without filing an application with the Commission and without a Commission order approving the transaction. Specifically, Alger Management and Alger Inc., as the investment adviser and principal underwriter, respectively, for the Alger Fund, participated in timing arrangements, including sticky asset arrangements, with select investors to permit them to time the Alger Fund without filing an application with the Commission and without a Commission order approving the transaction.

46. As a result of the conduct described above, Alger Management willfully violated Section 34(b) of the Investment Company Act by making untrue statements of material fact or omitting to state facts necessary in order to prevent the statements made, in the light of the circumstances under which they were made, from being materially misleading in a registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act or the keeping of which is required pursuant to Section 31(a) of the Investment Company Act. Specifically, Alger Management, on behalf of the Alger Fund, filed registration statements with the Commission that were materially misleading. Among other things, the registration statements, which included the Alger Fund prospectuses, falsely indicated that Alger Fund shareholders were limited to six exchanges per year.

47. As a result of the conduct described above, Alger Inc. willfully violated Section 15(c) of the Exchange Act in that, while registered with the Commission as a broker-dealer, it effected transactions in or induced or attempted to induce the purchase or sale of a security by means of a manipulative, deceptive, or other fraudulent device or contrivance. Among other

things, Alger Inc. participated in a fraudulent scheme by entering into arrangements with select investors, including sticky asset arrangements, that permitted these investors to market time in the Alger Fund, and this timing activity, among other things, exceeded limitations on exchanges in the Alger Fund prospectuses. Alger Inc. disseminated the materially false Alger Fund prospectuses to investors, knowing that these prospectuses contained materially false information. Alger Inc. also permitted one investor, Veras, to submit late trades in Alger mutual funds, but receive the same day's NAV in order to take advantage of post-market close information.

48. As a result of the conduct described above, Alger Inc. willfully violated Rule 22c-1 as adopted under Section 22(c) of the Investment Company Act in that, as the principal underwriter of a registered investment company issuing redeemable securities it sold, redeemed, or repurchased the shares of registered investment companies at prices not based upon the current net asset value of such securities computed after receipt of orders to sell, redeem, or purchase the shares of such registered investment companies. For example, Alger Inc. allowed Veras to engage in late trading in the Alger Fund.

### **RESPONDENTS' REMEDIAL ACTS**

49. In determining to accept the Offers, the Commission considered the remedial acts undertaken by Respondents and the cooperation afforded the Commission staff.

### **UNDERTAKINGS**

50. In determining to accept the Offers, the Commission has considered the following undertakings by Respondents.

51. Ongoing Cooperation. Respondents shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings to which the Commission is a party relating to or arising from the matters described in the Order. In connection with such cooperation, Respondents have undertaken:

- a. To produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission's staff;
- b. To use their best efforts to cause their employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;
- c. To use their best efforts to cause their employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and
- d. That in connection with any testimony of Respondents to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Respondents:

- i. Agree that any such notice or subpoena for Respondents' appearance and testimony may be served by regular mail on their attorney; and
- ii. Agree that any such notice or subpoena for Respondents' appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

52. Independent Compliance Consultant. Respondents shall retain, within 30 days of the date of entry of the Order, the services of an Independent Compliance Consultant not unacceptable to the staff of the Commission and a majority of the independent Trustees of the Alger funds. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by Respondents or their affiliates. Respondents shall require that the Independent Compliance Consultant shall conduct a comprehensive review of Respondents' supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by Respondents and their employees. This review shall include, but shall not be limited to, a review of Respondents' market timing controls, Respondents' sales and distribution practices, a review of the Alger funds' pricing practices that may make those funds vulnerable to market timing, a review of the Alger funds' utilization of short term trading fees and other controls for deterring excessive short term trading. Respondents shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to their files, books, records, and personnel as reasonably requested for the review.

- a. Respondents shall require that, at the conclusion of the review, which in no event shall be more than 120 days after the date of entry of the Order, the Independent Compliance Consultant shall submit a Report to Respondents, the Trustees of the Alger funds, and the staff of the Commission. The Report shall address the issues described in Paragraph 52 of these undertakings, and shall include a description of the review performed, the conclusions reached, the Independent Compliance Consultant's recommendations for changes in or improvements to policies and procedures of Respondents and the Alger funds, and a procedure for implementing the recommended changes in or improvements to Respondents' policies and procedures.
- b. Respondents shall adopt all recommendations with respect to Respondents contained in the Report of the Independent Compliance Consultant; provided, however, that within 150 days after the date of entry of the Order, Respondents shall in writing advise the Independent Compliance Consultant, the Trustees of the Alger funds and the staff of the Commission of any recommendations that they consider to be unnecessary or inappropriate. With respect to any recommendation that Respondents

consider unnecessary or inappropriate, Respondents 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.

- c. As to any recommendation with respect to Respondents' policies and procedures on which Respondents and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 180 days of the date of entry of the Order. In the event Respondents and the Independent Compliance Consultant are unable to agree on an alternative proposal acceptable to the staff of the Commission, Respondents will abide by the determinations of the Independent Compliance Consultant; provided, however, that if the Respondents believe it necessary to challenge any such determination of the Independent Compliance Consultant, the Respondents may apply to the Commission for an appropriate modification to this Order.
- d. Respondents (i) shall not have the authority to terminate the Independent Compliance Consultant, without the prior written approval of the majority of independent Trustees and the staff of the Commission; (ii) shall compensate the Independent Compliance Consultant, and persons engaged to assist the Independent Compliance Consultant, for services rendered pursuant to the Order at reasonable and customary rates as negotiated with the Respondents; and, (iii) shall not be in and shall not have an attorney-client relationship with the Independent Compliance Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultant from transmitting any information, reports, or documents to the Trustees or the Commission.
- e. Respondents shall require that the Independent Compliance Consultant, for the period of the engagement and for a period of two years from completion of the engagement, shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondents shall require that any firm with which the Independent Compliance Consultant is affiliated or of which the Independent Compliance Consultant is a member, and any person engaged to assist the Independent Compliance Consultant in performance of his or her duties under the Order shall not, without prior written consent of the independent Trustees and the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their 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.

53. Compliance Review. In 2008, Respondents shall undergo a compliance review by a third party, who is not an interested person, as defined in the Investment Company Act, of Respondents. At the conclusion of the review, the third party shall issue a report of its findings and recommendations concerning Respondents' supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by Respondents and their employees in connection with their duties and activities on behalf of and related to the Alger funds. The report shall be promptly delivered to Respondents' Compliance Oversight Committee and to a designated representative of the independent Board of Trustees of each Alger fund.

54. Independent Distribution Consultant. Respondents shall retain, within 30 days of the date of entry of the Order, the services of an Independent Distribution Consultant not unacceptable to the staff of the Commission and the independent Trustees of the Alger funds. The Independent Distribution Consultant's compensation and expenses, and all other costs of distributing the disgorgement and penalty ordered in Section IV of the Order, shall be borne exclusively by Respondents. Respondents shall cooperate fully with the Independent Distribution Consultant and shall provide the Independent Distribution Consultant with access to their files, books, records, and personnel as reasonably requested for the review. Respondents shall require that the Independent Distribution Consultant develop a Distribution Plan for the distribution of all of the disgorgement and penalty ordered in Section IV of the Order, and any interest or earnings thereon, according to a methodology developed in consultation with Respondents and acceptable to the staff of the Commission and the independent Trustees of the Alger funds. The Distribution Plan shall provide for investors in Alger Fund portfolios during the period from September 12, 2001 to October 15, 2003 to receive, from the monies available for distribution, in order of priority, (i) proportionate share of losses suffered by Alger Fund portfolios due to market timing and late trading, and (ii) a proportionate share of advisory fees paid by Alger Fund portfolios that suffered such losses during the period of such market timing and late trading.

- a. Respondents shall require that the Independent Distribution Consultant submit a Distribution Plan to Respondents and the staff of the Commission no more than 100 days after the date of entry of the Order.
- b. The Distribution Plan developed by the Independent Distribution Consultant shall be binding unless, within 130 days after the date of entry of the Order, Respondents or the staff of the Commission advises, in writing, the Independent Distribution Consultant of any determination or calculation from the Distribution Plan that it considers to be inappropriate and states in writing the reasons for considering such determination or calculation inappropriate.
- c. With respect to any determination or calculation with which Respondents or the staff of the Commission do not agree, such parties shall attempt in good faith to reach an agreement within 160 days of the date of entry of the Order. In the event that Respondents and the staff of the Commission are

unable to agree on an alternative determination or calculation, the determinations and calculations of the Independent Distribution Consultant shall be binding.

- d. Within 175 days of the date of entry of this Order, Respondents shall require that the Independent Distribution Consultant submit the Distribution Plan for the administration and distribution of disgorgement and penalty funds pursuant to Rule 1101 [17 C.F.R. 201.1101] of the Commission's Rules of Practice. Following a Commission order approving a final plan of disgorgement, as provided in Rule 1104 [17 C.F.R. 201.1104] of the Commission's Rules Regarding Fair Fund and Disgorgement Plans, Respondents shall require that the Independent Distribution Consultant, with Respondents, take all necessary and appropriate steps to administer the final plan for distribution of disgorgement and penalty funds.
- e. Respondents shall require that the Independent Distribution Consultant, for the period of the engagement and for a period of two years from completion of the engagement, not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondents shall require that any firm with which the Independent Distribution Consultant is affiliated or of which the Independent Distribution Consultant is a member, and any person engaged to assist the Independent Distribution Consultant in performance of his or her duties under the Order not, without prior written consent of the independent Trustees and the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their 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.

55. Independent Certification. No later than twenty-four months after the date of entry of the Order, the chief executive officers of Respondents shall certify to the Commission in writing that Respondents have fully adopted and complied in all material respects with the undertakings set forth in paragraphs 52 through 54 and 56 and with the recommendations of the Independent Compliance Consultant or, in the event of material non-adoption or non-compliance, shall describe such material non-adoption and non-compliance.

56. Recordkeeping. Respondents shall preserve for a period 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 Respondents' compliance with the undertakings set forth in paragraphs 52 through 55 and with the recommendations of the Independent Compliance Consultant.

57. Deadlines. For good cause shown, the Commission's staff may extend any of the

procedural dates set forth above.

#### IV.

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 the Offers.

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

A. Pursuant to Section 203(e) of the Advisers Act, Respondent Alger Management is hereby censured.

B. Pursuant to Section 203(e) of the Advisers Act and Section 15(b)(4) of the Exchange Act, Respondent Alger Inc. is hereby censured.

C. Respondent Alger Management shall cease and desist from committing or causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act, and Sections 17(d) and 34(b) of the Investment Company Act and Rule 17d-1 thereunder.

D. Respondent Alger Inc. shall cease and desist from committing or causing any violations and any future violations of Section 15(c) of the Exchange Act, and Section 17(d) of the Investment Company Act and Rules 17d-1 and 22c-1 as adopted under Section 22(c) of the Investment Company Act, and causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act.

E. Respondents shall, within 30 days of the entry of this Order, pay, on a joint and several basis, \$30,000,000 in disgorgement plus a civil money penalty in the amount of \$10,000,000 for a total of payment of \$40,000,000. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) wired, hand-delivered, or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22132; and (D) submitted under cover letter that identifies Alger Management and Alger Inc. as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter, wire transfer instruction, money order, or check shall be sent to Mark K. Schonfeld, Regional Director, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, 4<sup>th</sup> Floor, New York, New York 10281-1022. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("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, Respondents agree that they shall not, in any Related Investor Action, benefit from any offset or reduction of any investor's claim by the amount of any Fair Fund distribution to such investor in

this proceeding that is proportionately attributable to the civil penalty paid by Respondents ("Penalty Offset"). If the court in any Related Investor Action grants such an offset or reduction, Respondents agree that they shall, within 30 days after entry of a final order granting the offset or reduction, 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 against Respondents in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order in this proceeding.

F. Respondents shall comply with the undertakings set forth in paragraphs 52 through 56 above.

By the Commission.

Nancy M. Morris  
Secretary

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

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**

Release No. 8774 / January 18, 2007

**SECURITIES EXCHANGE ACT OF 1934**

Release No. 55123 / January 18, 2007

**INVESTMENT ADVISERS ACT of 1940**

Release No. 2581 / January 18, 2007

**INVESTMENT COMPANY ACT OF 1940**

Release No. 27667 / January 18, 2007

**ADMINISTRATIVE PROCEEDING**

File No. 3-12541

In the Matter of

**KELMOORE  
INVESTMENT COMPANY,  
INC.,**

Respondent.

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-  
DESIST ORDER PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933, SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTION 203(e) OF THE INVESTMENT  
ADVISERS ACT OF 1940, AND  
SECTIONS 9(b) AND 9(f) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**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 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Kelmoore Investment Company, Inc. ("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

*Document 31 of 54*

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, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, Section 203(e) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

### **III.**

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

#### **Summary**

1. From 1999 to 2005, Kelmoore Investment Company, Inc. ("Kelmoore"), a dually registered investment adviser and broker-dealer, understated the total fees it charged for managing five mutual funds ("the Funds"). Kelmoore's publicly disclosed advisory fee of 1% of assets under management did not include the substantial brokerage commissions which Kelmoore additionally charged for certain services that normally, in the context of providing advice to mutual funds, would be deemed advisory services. Kelmoore's disclosures were misleading and had the effect of obscuring from mutual fund shareholders the full cost of these investment advisory services. The misleading disclosures also prevented investors from making a fair comparison of the advisory fees charged by Kelmoore and the fees charged by other mutual funds.

#### **Respondent**

2. Kelmoore Investment Company, Inc. was incorporated in California in 1978, and became registered with the Commission as an investment adviser in 1996. Kelmoore has also been registered with the Commission as a broker-dealer since 1988. During the relevant time period, Kelmoore served as both the investment adviser and broker-dealer for the Kelmoore Strategic Trust and the Kelmoore Strategy Variable Trust.

#### **Facts**

##### ***Kelmoore's Dual Role as Investment Adviser and Broker-Dealer***

3. Kelmoore is a single, dually-registered entity that served as both the adviser and the broker-dealer for the Funds during the relevant period. Kelmoore has no subsidiaries.

4. Kelmoore's strategy for the Funds involved writing options on stocks owned by the Funds in order to generate cash flow. To implement its strategy, Kelmoore purchased common stocks in large or mid-cap companies that had adequate price fluctuation in order for the Funds to write options that would generate high premiums. According to Kelmoore, this

complex strategy was quite labor intensive. For instance, Kelmoore needed to determine the timing and terms of the options (such as duration, price and strike price), when to buy puts to hedge downside risk, when to close out options contracts, and when to establish new contracts. When the Funds generated positive cash flow, they would make monthly distributions to the shareholders.

### ***Kelmoore's Disclosure of its Advisory Fees Was Misleading***

5. Kelmoore oversaw the preparation of and was responsible for the Funds' initial registration statements, including the prospectuses, and continued to be responsible for the misrepresentations contained in the Funds' subsequent registration statements. Although the Funds' prospectuses reported that Kelmoore charged an advisory fee equal to 1% of assets under management, in actuality investors in the Funds paid an advisory fee from 1.5% to over 3%. Kelmoore obscured the magnitude of these fees by suggesting in the prospectuses that the 1% fee covered all of the significant advisory work done by the firm. In fact, Kelmoore charged the Funds brokerage commissions designed in part to compensate the firm for this work. Kelmoore's commission charges were substantial -- \$5.63 per option contract. The Funds' prospectuses did not adequately describe the advisory work Kelmoore performed in return for brokerage commissions as opposed to the work Kelmoore performed in return for the 1% advisory fee. Kelmoore's disclosures were therefore misleading in light of the manner in which Kelmoore divided up the work it performed for the Funds. As a result, it would have been difficult for investors to understand the amount they were paying for advisory services or make an informed investment decision when comparing the Kelmoore Funds to other mutual funds.

6. Additionally, the Funds' prospectuses, which repeatedly referred to Kelmoore as "the Advisor," were misleading in suggesting that the options strategy was being managed by Kelmoore in its capacity as an investment adviser and that Kelmoore was compensated for these services through the 1% advisory fee. Contrary to what a reasonable investor might infer from reading the prospectuses, Kelmoore in its capacity as an adviser performed limited work to implement the Funds' options strategy.

7. Had Kelmoore's advisory fee included all the money it charged for options strategy services, its advisory fee would have been over 3% for some periods, rather than the 1% reported to investors and potential investors.

8. Kelmoore consulted with counsel in preparing its disclosures and the Funds' Boards understood and approved of the fees and commissions that the Funds were paying. Even so, Kelmoore's disclosures were materially misleading, which had the effect of benefiting Kelmoore and harming Fund investors. Kelmoore is responsible for the disclosures that it made to investors. Kelmoore also disclosed that its complex options strategy could result in higher commissions than would normally be charged by other broker-dealers and Kelmoore annually reported the Funds' commission expenses as required in the Funds' Statement of Additional Information. Nevertheless, Fund investors would have had difficulty determining from the Funds' disclosures what they were paying Kelmoore in return for its advisory services and it was Kelmoore's obligation to ensure that those disclosures were not misleading.

9. Kelmoore has recently made changes to the Funds' prospectus and SAI that are intended to more accurately describe Kelmoore's dual roles as both an investment adviser and a broker-dealer. In addition, Kelmoore no longer charges commissions for options strategy services. Instead, all of its advisory services are provided in return for the disclosed advisory fee.

### **Violations**

10. As a result of the conduct described above, Kelmoore willfully violated:

a. Section 17(a)(3) of the Securities Act in that it engaged in a "transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser." Specifically, Kelmoore was responsible for the misrepresentations contained in the Funds' prospectuses and SAIs. In those documents, Kelmoore misrepresented the total amount of Fund expenses for advisory services by stating its advisory fees were 1% of average daily net assets when in actuality total fees for Kelmoore's services were from 1.5% to over 3.0%. Kelmoore's business practice had the effect of misrepresenting its total fees by not including fees for certain services related to writing options; and

b. Section 34(b) of the Investment Company Act in that it made untrue statements of material fact in a registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act, or omitted to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they made, from being materially misleading.

### **Kelmoore's Remedial Efforts**

11. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

### **Undertakings**

12. Respondent Kelmoore undertakes:

a. To hire for fiscal year 2006, at its expense, an Independent Consultant not unacceptable to the staff to: (1) review at year-end the advisory fees and options commissions charged to comparable funds and to make a report with recommendations thereafter on Kelmoore's policies, procedures, and practices for pricing its advisory fees and options commissions; and (2) review Kelmoore's compliance with relevant rules and regulations governing commissions and fees including, among other things, the best execution obligations;

b. Within 60 days of completing the 2006 year-end review, to require the Independent Consultant to submit a report of his/her findings and recommendations to Kelmoore, the independent trustees of the Kelmoore Strategic Trust and to Marc J. Fagel, Associate District Administrator, of the Commission's San Francisco District Office;

c. To require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years after completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kelmoore, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such other than the Funds' Independent Trustees. The agreement also will 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 Commission's San Francisco District Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Kelmoore, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such other than the Funds' Independent Trustees for the period of the engagement and for a period of two years after the engagement;

d. Within thirty (30) days of entry of the Order, to mail a copy of this Order, together with a cover letter in a form not unacceptable to the staff, to each of the existing shareholders of the Kelmoore Strategic Trust. Within forty-five (45) days of entry of this Order, Kelmoore shall certify in writing that this undertaking has been completed to Marc J. Fagel, Associate District Administrator of the Commission's San Francisco District Office;

e. From the effective date of this Order until the expiration of 365 days, to maintain a link to this Order on the home page of any and all of Kelmoore's website(s) (to the extent Kelmoore maintains more than one website) in a form not unacceptable to the staff of the Commission. Within thirteen (13) months from the date of this Order, Kelmoore shall certify in writing that this undertaking has been completed to Marc J. Fagel, Associate District Administrator of the Commission's San Francisco District Office.

#### IV.

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

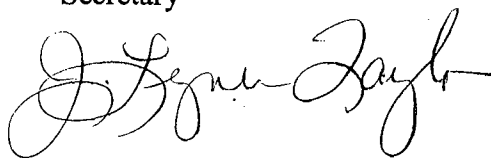
Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Section 203(e) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

- A. Respondent Kelmoore is hereby censured.
- B. Respondent Kelmoore shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act, and Section 34(b) of the Investment Company Act.
- C. Respondent Kelmoore shall comply with the undertakings enumerated in paragraph 12 above.
- D. Respondent Kelmoore shall pay a civil penalty in the amount of \$100,000 to the United States Treasury within 30 days of entry of this Order. Payment of the civil penalty shall

be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Kelmoore as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helane L. Morrison, District Administrator, Securities and Exchange Commission, San Francisco District Office, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

By the Commission.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

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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.B.3. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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. Wachtel, age 42, was at all relevant times prior to February 2004 a certified public accountant licensed to practice in the State of California. He served as Controller of NextCard, Inc. ("NextCard" or the "Company") from 1998 to 2003.

2. NextCard was, at all relevant times, a Delaware corporation with its principal place of business in San Francisco, California. NextCard was engaged in the business of issuing credit cards over the Internet. At all relevant times, NextCard's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ National Market. NextCard declared bankruptcy in November 2002.

3. On September 28, 2004, the Commission filed a complaint against Wachtel and others entitled SEC v. Lent, et al., (Civil Action No. 04-4088 (N.D. Cal.)). On October 27, 2006, the court entered an order permanently enjoining Wachtel, by consent, from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Wachtel was also ordered to pay disgorgement, prejudgment interest and civil money penalties totaling \$93,223.

4. The Commission's Complaint alleged, among other things, that Wachtel and the other defendants, all former officers of NextCard, engaged in a fraudulent scheme which resulted in NextCard filing materially false and misleading financial statements in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2000, and in the company's quarterly reports on Form 10-Q for the first two quarters of fiscal year 2001. The Complaint alleged that Wachtel and the other defendants failed to disclose several changes in NextCard's accounting policies, including: (1) the reclassification of certain credit losses as fraud losses; and (2) changes in NextCard's policy for calculating its loan loss reserve. According to the Complaint, as a result of these undisclosed accounting policy changes, investors were misled and denied material information concerning the rising levels of losses on NextCard's credit card portfolio.

#### IV.

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

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

A. Wachtel is suspended from appearing or practicing before the Commission as an accountant.

B. After 5 years 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/she 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 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

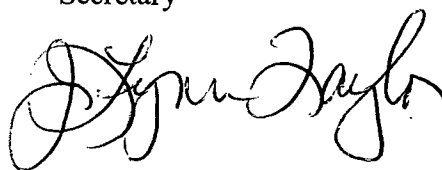
(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. 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.

By the Commission.

Nancy M. Morris  
Secretary

A handwritten signature in cursive script, appearing to read "J. Lynn Taylor".

By: J. Lynn Taylor  
Assistant Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PART 240**

**[RELEASE NOS. 34-55147; IC-27672; File No. S7-03-07]**

**RIN 3235-AJ79**

**UNIVERSAL INTERNET AVAILABILITY OF PROXY MATERIALS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to the proxy rules under the Securities Exchange Act of 1934 that would require issuers and other soliciting persons to furnish proxy materials to shareholders by posting them on an Internet Web site and providing shareholders with notice of the availability of the proxy materials. In a separate release, we concurrently are adopting rules that allow issuers and other soliciting persons to voluntarily furnish proxy materials to shareholders in this manner. The proposed amendments are intended to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications.

**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

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- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-03-07 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 in triplicate to Nancy M. Morris, Secretary,  
Securities and Exchange Commission, 100 F Street, NE, Washington, DC  
20549-1090.

All submissions should refer to File Number S7-03-07. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on its Internet Web site (<http://www.sec.gov/rules/proposed.shtml>).

Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Raymond A. Be, Special Counsel,  
Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing amendments to Rules 14a-7,<sup>1</sup> 14a-16,<sup>2</sup> 14b-1,<sup>3</sup> 14b-2,<sup>4</sup> 14c-2,<sup>5</sup> and 14c-3<sup>6</sup> under the Securities Exchange Act of 1934.<sup>7</sup>

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<sup>1</sup> 17 CFR 240.14a-7.

<sup>2</sup> 17 CFR 240.14a-16.

<sup>3</sup> 17 CFR 240.14b-1.

<sup>4</sup> 17 CFR 240.14b-2.

<sup>5</sup> 17 CFR 240.14c-2.

<sup>6</sup> 17 CFR 240.14c-3.

<sup>7</sup> 15 U.S.C. 78a *et seq.*

- H. Solicitation of Comment
- IX. Small Business Regulatory Enforcement Fairness Act
- X. Statutory Basis and Text of Proposed Amendments

## **I. Introduction**

Currently, issuers decide whether to provide shareholders with the choice to receive proxy materials by electronic means. We are proposing amendments to the proxy rules that would require issuers and other soliciting persons to furnish proxy materials to shareholders by posting them on an Internet Web site and providing shareholders with notice of the availability of the proxy materials.<sup>8</sup> The proposal, if adopted, would provide all shareholders with the ability to choose whether to receive proxy materials in paper, by e-mail or via the Internet. We believe that universal Internet availability of proxy materials has the potential to enhance significantly the ability of investors to make informed voting decisions regarding the securities that they hold. In a companion release, we are adopting an Internet availability model that issuers and other soliciting persons may follow on a voluntary basis.<sup>9</sup> We are considering making the universal Internet availability amendments effective for large accelerated filers, not including registered investment companies, on January 1, 2008,<sup>10</sup> and for all other issuers, including registered investment companies, on January 1, 2009.

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<sup>8</sup> For purposes of this release, the term "proxy materials" includes proxy statements on Schedule 14A [17 CFR 240.14a-101], proxy cards, information statements on Schedule 14C [17 CFR 240.14c-101], annual reports to security holders required by Rules 14a-3 [17 CFR 240.14a-3] and 14c-3 [17 CFR 240.14c-3] of the Exchange Act, notices of shareholder meetings, additional soliciting materials, and any amendments to such materials. For purposes of this release, the term does not include materials filed under Rule 14a-12 [17 CFR 240.14a-12].

<sup>9</sup> Release No. 34-55146 (Jan. 22, 2007).

<sup>10</sup> A large accelerated filer, as defined in Exchange Act Rule 12b-2 [17 CFR 240.12b-2], is an issuer that, as of the end of its fiscal year, has an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of \$700 million or more, as measured on the last business day of the issuer's most recently completed

## II. Description of Proposed Amendments

Under the proposal, an issuer that is required to furnish proxy materials to shareholders under the Commission's proxy rules would have to satisfy this requirement by posting its proxy materials on a specified, publicly-accessible Internet Web site (other than the Commission's EDGAR Web site) and providing record holders with a notice informing them that the materials are available and explaining how to access those materials. Issuers and intermediaries also would be required to follow the universal Internet availability model<sup>11</sup> to furnish proxy materials to beneficial owners.

Shareholders and other persons conducting their own proxy solicitations also would be required to follow the universal Internet availability model. Shareholders would retain the ability to request paper or e-mail copies for a particular meeting or to make a permanent request for proxy materials relating to all shareholder meetings.<sup>12</sup> By requiring universal Internet availability of proxy materials, the proposed amendments are designed to enhance the ability of investors to make informed voting decisions and to expand use of the Internet to ultimately lower the costs of proxy solicitations.

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second fiscal quarter; has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and is not eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports.

<sup>11</sup> In this release, we are referring to the proposal as the "universal Internet availability" model. This model is substantially similar to the "notice and access" model for electronically furnishing proxy materials referred to in Release No. 34-55146 that issuers and other soliciting persons may follow on a voluntary basis.

<sup>12</sup> A shareholder may revoke a permanent election to receive paper or e-mail copies at any time.

#### **A. Universal Internet Availability Model for Issuers**

Under the proposal, an issuer would be required to comply with the following requirements, which are substantially similar to the requirements that we are adopting under the voluntary model.<sup>13</sup> First, the issuer would have to send a Notice of Internet Availability of Proxy Materials ("Notice") to shareholders at least 40 calendar days before the shareholder meeting date, or if no meeting is to be held, at least 40 calendar days before the date that votes, consents, or authorizations may be used to effect a corporate action, indicating that the issuer's proxy materials are available on a specified Internet Web site and explaining how to access those proxy materials.

The Notice would have to contain the same information that is required under the voluntary model, including the following:<sup>14</sup>

- A prominent legend in bold-face type that states:  
  
**"Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].**
  - **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.**
  - **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**
  - **If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery."**

<sup>13</sup> See 17 CFR 240.14a-16 [17 CFR 240.14a-16].

<sup>14</sup> Appropriate changes must be made if the issuer is providing an information statement pursuant to Regulation 14C or seeking to effect a corporate action by written consent.

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on and the issuer's recommendations regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- (1) A toll-free telephone number; (2) an e-mail address; and (3) an Internet Web site address where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the Notice relates;
- Any control/identification numbers that the shareholder needs to access his or her proxy card;
- Instructions on how to access the proxy card, provided that such instructions do not enable a shareholder to execute a proxy without having access to the proxy statement and annual report; and
- Information about attending the shareholder meeting and voting in person.

The Notice would have to be written in plain English. The Notice may contain only the information specified by the rules and any other information required by state law, if the issuer chooses to combine the Notice with any shareholder meeting notice that state law may require. However, the Notice may contain a protective warning to shareholders, advising them that no personal information other than the identification or control number is necessary to execute a proxy. The issuer would have to file its Notice

with the Commission pursuant to Rule 14a-6(b)<sup>15</sup> no later than the date that it first sends the Notice to shareholders.

An issuer would have to make all proxy materials identified in the Notice publicly accessible, free of charge, at the Web site address specified in the Notice on or before the date that the Notice is sent to the shareholder. The specified Web site may not be the Commission's EDGAR system. The issuer also would have to post any subsequent additional soliciting materials on the Web site no later than the date on which such materials are first sent to shareholders or made public. The materials would have to be presented on the Web site in a format, or formats, convenient for both reading online and printing on paper.<sup>16</sup>

The proxy materials would have to remain available on that Web site through the conclusion of the shareholder meeting. An issuer also would have to provide shareholders with a method to execute proxies as of the time the Notice is first sent to shareholders. It may do so through a variety of methods, including providing an electronic voting platform or a toll-free telephone number for voting.<sup>17</sup>

An issuer would be required to provide copies at no charge to requesting shareholders. It also would have to allow shareholders to make a permanent election to receive paper or e-mail copies of proxy materials distributed in connection with future proxy solicitations of the issuer. Further, the issuer would have to provide a toll-free telephone number, e-mail address, and Internet Web site address as a means by which a

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<sup>15</sup> 17 CFR 240.14a-6(b).

<sup>16</sup> See Section II.A.3 of Release 34-55146.

<sup>17</sup> As noted above, such a telephone number may appear on the Web site, but not on the Notice.

shareholder could request a copy of the proxy materials for the particular shareholder meeting referenced in the Notice or make a permanent election to receive copies of the proxy materials on a continuing basis with respect to all meetings. The issuer also may include a pre-addressed, postage-paid reply card with the Notice that shareholders could use to request a copy of the proxy materials.

An issuer would not be permitted to send a proxy card to a shareholder until 10 calendar days or more after the date it sent the Notice to the shareholder, unless the proxy card is accompanied or preceded by a copy of the proxy statement and any annual report to security holders sent via the same medium. Issuers would be able to household the Notice and other proxy materials pursuant to Rule 14a-3(e).<sup>18</sup> An issuer would have to maintain the Internet Web site on which it posts its proxy materials in a manner that does not infringe on the anonymity of a person accessing that Web site.<sup>19</sup> An issuer also could not use any e-mail address provided by a shareholder solely to request a copy of proxy materials for any purpose other than to send a copy of those materials to that shareholder. The issuer also may not disclose a shareholder's e-mail address to any person other than the issuer's employee or agent to the extent necessary to send a copy of the proxy materials to a requesting shareholder. An issuer could not use the universal Internet availability model in the context of a business combination transaction.

#### **Request for Comment**

- What advantages would universal Internet availability of proxy materials have for investors, issuers and other soliciting persons? What

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<sup>18</sup> 17 CFR 240.14a-3(e).

<sup>19</sup> See Section II.A.1.b.iii of Release No. 34-55146.

disadvantages could the proposal have? How could any potential disadvantages be mitigated?

- Should we require issuers to follow the universal Internet availability model as proposed? If not, why not? Would requiring issuers to follow the universal Internet availability model impose significant costs on issuers? If so, what would they be? How could the proposal be modified to mitigate these costs? Would requiring issuers to follow the universal Internet availability model positively or negatively affect shareholder voting participation rates?
- Should we exempt certain types of issuers from the proposed universal Internet availability model? For example, should we exempt small business issuers? Should we require mutual funds, closed-end funds, business development companies and other investment companies to follow the model? Should the model be equally applicable to all types of shareholders and/or all types of solicitations except those relating to business combination transactions?
- Under the voluntary model, an issuer may choose not to rely on the universal Internet availability model if it conflicts with state law. We are not aware of any state law conflicts. Are there any state laws that would conflict with the universal Internet availability model?
- Should we modify any aspects of the universal Internet availability model? If so, how should the model be modified and why? Should there be any changes to the timeframes for sending the Notice, the contents of the

Notice or the types of materials that can be sent with the Notice? Should any revisions be made to the Web site posting requirements or the requirements to send copies upon request?

- Some proxy solicitations are not subject to the requirements of Section 14(a) of the Exchange Act, such as proxy solicitations with respect to foreign private issuers. However, we understand that proxy solicitations relating to foreign private issuers generally are processed and distributed in accordance with the same procedures set forth in our proxy rules because intermediaries and their agents are not able to apply cost-effectively different procedures to exempt proxy solicitations. Would a universal Internet availability model create a burden on those issuers who are not subject to Section 14(a)? If so, how can those burdens best be addressed?

**B. Implications of the Universal Internet Availability Model for Intermediaries**

With respect to beneficial owners, the issuer or other soliciting person would have to provide each intermediary with the information necessary to prepare the intermediary's Notice in sufficient time for the intermediary to prepare and send its Notice to beneficial owners at least 40 calendar days before the shareholder meeting date.<sup>20</sup> The intermediary's Notice would contain generally the same types of information as an

<sup>20</sup>

A soliciting person other than the issuer must provide intermediaries with such information in sufficient time for the intermediaries to prepare and send the intermediary's Notice by the later of: (1) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; or (2) 10 calendar days after the date that the registrant first sends its proxy statement or Notice of Internet

issuer's Notice, but would be tailored specifically for beneficial owners.<sup>21</sup> Intermediaries would be required to prepare and send this tailored Notice to beneficial owners. The intermediaries also would be required to forward paper or e-mail copies to beneficial owners upon request. Finally, intermediaries would have to post their requests for voting instructions on an Internet Web site, permit shareholders to make a permanent election to receive paper or e-mail copies of the proxy materials, keep records of those elections, and deliver copies of the proxy materials according to those elections.

#### **Request for Comment**

- Should we make any modifications to the universal Internet availability model as it would apply to intermediaries if we adopt this proposal? If so, how should the model be modified and why? Should there be any changes to the timeframes for sending the intermediary's Notice, the contents of the intermediary's Notice or the types of materials that could be sent with the Notice? Should any revisions be made to the Web site posting requirements or the requirements to send copies upon request?

#### **C. Universal Internet Availability Model for Soliciting Persons Other Than the Issuer**

A soliciting person other than the issuer also would be required to follow the universal Internet availability model. Consistent with the existing proxy rules and the voluntary model, the proposed rules treat such soliciting persons differently from the issuer in certain respects.

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Availability of Proxy Materials to security holders. See Rule 14a-16(l)(2) [17 CFR 240.14a-16(l)(2)].

<sup>21</sup> For a more complete discussion of the content of the intermediary's Notice, see Section II.B.2 of Release No. 34-55146.

First, a soliciting person is not required to solicit every shareholder. It may select the specific shareholders from whom it wishes to solicit proxies. Under the proposed universal Internet availability model, a soliciting person other than the issuer would be able to choose to send Notices only to those shareholders who have not previously requested paper copies.<sup>22</sup>

Second, soliciting persons other than the issuer would be required to send a Notice to shareholders by the later of:

- 40 calendar days prior to the shareholder meeting date or, if no meeting is to be held, 40 calendar days prior to the date that votes, consents, or authorizations may be used to effect the corporate action; or
- 10 calendar days after the date that the issuer first sends its proxy materials to shareholders.

Finally, if at the time the Notice is sent, a soliciting person other than the issuer is not aware of all matters on the shareholder meeting agenda, the Notice would have to provide a clear and impartial identification of each separate matter to be acted upon at the meeting, to the extent known by the soliciting person. The soliciting person's Notice also would have to include a clear statement that there may be additional agenda items that the soliciting person is unaware of, and that the shareholder cannot direct a vote for those items on the soliciting person's proxy card provided at that time. If a soliciting person other than the issuer sends a proxy card that does not reference all matters that

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<sup>22</sup> Under Rule 14a-7 [17 CFR 240.14a-7], an issuer is required to either mail the Notice on behalf of the soliciting person, in which case the soliciting person can request that the issuer send Notices only to shareholders who have not requested paper copies, or provide the soliciting person with a shareholder list, indicating which shareholders have requested paper copies. For a more complete discussion of the interaction of the model with Rule 14a-7, see Section II.C.4 of Release No. 34-55146.

shareholders will act upon at the meeting, the Notice would have to clearly state whether execution of the proxy card would invalidate a shareholder's prior vote using the issuer's card on matters not presented on the soliciting person's proxy card.

### **Request for Comment**

- Should we require soliciting persons other than the issuer to follow the universal Internet availability model? If not, why not? Would the universal Internet availability model impose significant costs on soliciting persons other than the issuer? If so, what would they be and how could they be mitigated?
- Rule 14a-2(a)(6)<sup>23</sup> permits a soliciting person to solicit proxies without otherwise complying with Rules 14a-3 through 14a-15<sup>24</sup> by placing a newspaper advertisement which does no more than inform shareholders of (1) a source from which they may obtain copies of a proxy statement, proxy card and other soliciting materials, (2) the name of the issuer, (3) the reason for the advertisement, and (4) the proposals to be acted upon by shareholders. Should the universal Internet availability model apply to such solicitations? If so, how should it apply? In light of the amendments, should we keep such a model available to soliciting persons?
- Should we make any revisions to Rule 14a-7 to accommodate the universal Internet availability model?

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<sup>23</sup> 17 CFR 240.14a-2(a)(6).

<sup>24</sup> 17 CFR 240.14a-3 through 240.14a-15.

- If we adopt the universal Internet availability model, should we modify any aspects of the model as it relates to soliciting persons other than the issuer? If so, how should the proposed model be modified and why?  
Should there be any changes to the timeframes for sending the Notice, the contents of the Notice or the types of materials that can be sent with it?  
Should any revisions be made to the Web site posting requirements or the requirements to send copies upon request?

**D. Option to Send Full Set of Proxy Materials with Notice Under the Universal Internet Availability Model**

Under the voluntary model that we are adopting, issuers or other soliciting persons are obligated to provide a paper or e-mail copy of the proxy materials upon request to a shareholder to whom they have provided a Notice. Issuers and other soliciting persons are not allowed to send the Notice with any document other than a notice of shareholder meeting required under state law and a pre-printed, postage-paid reply card for a shareholder to request a copy of the proxy materials.

Under the proposed universal Internet availability model, a full set of proxy materials, including a proxy statement, annual report (if required), and proxy card or request for voting instructions could accompany the Notice that is sent to shareholders and beneficial owners.<sup>25</sup> This would allow an issuer or other soliciting person that wants to furnish paper copies of the proxy materials to some or all of its shareholders in the first instance to do so in one delivery with the Notice. This is different from the voluntary

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<sup>25</sup> The requirement in Exchange Act Rules 14a-3(b) and 14c-3(a) to furnish annual reports to security holders does not apply to registered investment companies [17 CFR 240.14a-3(b) and 240.14c-3(a)]. A soliciting person other than the issuer also is not subject to this requirement.

notice and access model because presumably an issuer or soliciting person would not choose to rely on the model if it intended to furnish paper copies of the proxy materials to all of the shareholders it was soliciting. As this proposal would require an issuer to follow the universal Internet availability model, it is necessary to expressly provide a means for issuers that also wish to send paper copies of the proxy materials along with the Notice as part of the same delivery package to shareholders to do so under the model.

The proposal would not permit an issuer or other soliciting person to initially send the Notice with other proxy materials, unless it is accompanied by a full set of proxy materials.<sup>26</sup> For example, an issuer or other soliciting person would not be permitted to send initially only the Notice and a proxy card to shareholders.<sup>27</sup> Instead, it would have to send a full set of proxy materials with the Notice, or send only the Notice. An issuer or other soliciting person choosing to deliver a full set of proxy materials with the Notice would be permitted to revise its Notice to delete any reference to a shareholder's right to request copies of the materials because all required proxy materials already would have been sent to shareholders.

If an issuer or other soliciting person sends a full set of the proxy materials with the Notice, it need not comply with the deadlines in Rule 14a-16 for sending the Notice. Thus, if an issuer is unable or unwilling to meet the 40-day deadline, it still may begin its solicitation after that deadline provided that it accompanies its Notice with a full set of the proxy materials. Similarly, a soliciting person other than the issuer that fails to send

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<sup>26</sup> A "full set" of proxy materials would contain (1) a proxy statement or information statement, (2) an annual report if one is required by Rule 14a-3(b) or Rule 14c-3(a), and (3) a proxy card or, in the case of a beneficial owner, a request for voting instructions, if proxies are being solicited.

<sup>27</sup> However, it may send the Notice and proxy card together 10 calendar days or more after it initially sends the Notice. See Rule 14a-16(h) [17 CFR 240.14a-16(h)].

its Notice by the later of 40 calendar days before the meeting date or 10 calendar days after the issuer first sends its proxy materials could begin its solicitation after that deadline if it accompanies its Notice with a full set of proxy materials.

We also propose to permit a registered investment company to send its prospectus and/or report to shareholders together with the Notice, with or without the proxy statement and form of proxy. While the proxy rules do not require registered investment companies to furnish annual reports to security holders with their proxy materials, under the Investment Company Act of 1940, registered investment companies are required to transmit a report to shareholders at least semi-annually.<sup>28</sup> In addition, many mutual funds send their prospectuses to their existing shareholders annually in order to meet prospectus delivery obligations with respect to additional share purchases. Without our proposal for registered investment companies, they would be required to deliver both their prospectuses and shareholder reports separately from the Notice, which could result in increased costs to fund shareholders.

#### **Request for Comment**

- Should issuers and other soliciting persons be allowed to accompany the Notice with a full set of proxy materials?
- Is there potential for confusion if issuers and other soliciting persons choose to deliver to shareholders a full set of proxy materials in paper, but also send a Notice to them? If an issuer chooses to send a full set of the proxy materials with the Notice to a shareholder under this option, should the rules permit the issuer to incorporate the information required in the

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<sup>28</sup> 15 U.S.C. 80a-29(e).

Notice into the proxy statement or some other document, rather than prepare a separate Notice?

- Should issuers, soliciting persons and intermediaries be permitted to remove the right to request copies if a full set of the proxy materials is included with the Notice, as proposed?
- Should registered investment companies be permitted to accompany the Notice with a prospectus and/or report to shareholders? If so, should they be permitted to do this without also including a proxy statement and form of proxy? Is there any other category of issuer for which a similar accommodation would be appropriate?
- The proposed deadlines for sending the Notice are intended to provide shareholders with sufficient time to request copies. If an issuer or other soliciting person is unable to meet the deadlines under the universal Internet availability model, should either be permitted to begin its solicitation after those deadlines have passed if a full set of proxy materials accompanied the Notice, as proposed?
- If an issuer or other soliciting person elected to send a full set of proxy materials with the Notice, should it be permitted to include additional soliciting materials with the Notice as well?
- Are there any complications that might arise with respect to intermediaries by providing issuers and other soliciting persons the option to provide a full set of proxy materials? If so, how could these complications be addressed?

### **III. Compliance Dates**

Issuers and other soliciting persons may begin complying with the voluntary model on July 1, 2007. We are soliciting comment on compliance dates for the universal Internet availability model. If adopted, we are considering making the universal Internet availability model effective for large accelerated filers, not including registered investment companies, on January 1, 2008, and for all other issuers, including registered investment companies, on January 1, 2009. Such a tiered compliance regime may lessen any burden imposed by requiring smaller companies to follow the model.

In determining an appropriate compliance date for the universal Internet availability model, we are considering the extent to which we will be able to study the implementation of the voluntary model before adopting the universal Internet availability model. The industry's experience with these models will provide information on whether the rules are achieving their intended purposes. We welcome information from issuers and all other parties involved in the proxy distribution process. This information would include:

- The ability of issuers to provide shareholders with qualitatively better disclosure using the additional features available on the Internet, including XBRL, graphical, comparative and interactive features;
- The extent to which issuers and other soliciting persons avail themselves of opportunities to exploit other linked data and resources, and make these available to shareholders in ways that are not possible with printed material;
- The impact on shareholder understanding of complex material;

- The effect of the model on proxy voting;
- The impact on costs of proxy solicitation;
- Shareholder voting data before and after adoption, including data on shareholder voting participation rates;
- The number of paper copies of proxy materials requested by shareholders;
- Any problems encountered with implementing the program, including problems encountered by smaller issuers; and
- Shareholder satisfaction with their choices of ways to communicate with the company.

#### **Request for Comment**

- What compliance dates would be appropriate for the universal Internet availability model? Should we permit at least one proxy season under the voluntary model to pass before requiring use of the universal Internet availability model? What compliance dates would give us and the market sufficient time to examine the performance of the voluntary model if we decide to convert to the universal Internet availability model after January 1, 2008?
- Should we adopt a tiered system of compliance dates for compliance with the universal Internet availability model, as we are considering doing? For example, should we require that some class of issuer, such as large accelerated filers, comply with the universal Internet availability model initially, and that other filers comply at a later date? If so, what should those dates be and which category of filers should go first?

- If we were to adopt a tiered system of compliance dates, how many tiers should there be? What would be the appropriate classes (e.g., large accelerated filers, accelerated filers, or small business issuers) for each tier? Should we divide issuers differently?
- What compliance dates would be appropriate for mutual funds, closed-end funds, business development companies, and other investment companies?
- Should there be a different compliance date for soliciting persons other than issuers? If so, why and what compliance dates would be appropriate?

#### **IV. General Request for Comment**

We request and encourage any interested person to submit comments regarding:

- (1) The proposed changes that are the subject of this release,
- (2) Additional or different changes, or
- (3) Other matters that may have an effect on the proposals contained in this release.

With regard to any comments, we note that such comments are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

#### **V. Paperwork Reduction Act**

Certain provisions of the amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”), including preparation of Notices, maintaining Web sites, maintaining records of

shareholder preferences, and responding to requests for copies. The titles for the collections of information are:<sup>29</sup>

Regulation 14A (OMB Control No. 3235-0059)

Regulation 14C (OMB Control No. 3235-0057)

We requested public comment on these collections of information in the release proposing the notice and access model as a voluntary model for disseminating proxy materials,<sup>30</sup> and submitted them to the Office of Management and Budget ("OMB") for review in accordance with the PRA. We received approval for the collection of information. We are submitting a revised PRA analysis to OMB in conjunction with the release adopting the notice and access model as a voluntary model. In that release, we assumed conservatively that all issuers and other persons soliciting proxies would follow the voluntary model because the proportion of issuers and other soliciting persons that would elect to follow the model was uncertain.

The proposed rules would require all issuers and other soliciting persons to follow the model. Therefore, our preliminary estimate is that the rule amendments that we are proposing in this release will not impose any new recordkeeping or information collection requirements beyond those described in the release adopting the voluntary model, or necessitate revising the burden estimates for any existing collections of

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<sup>29</sup> In connection with the proposing release for the voluntary model, we described the proposed Notice of Internet Availability of Proxy Materials as a new collection of information, rather than a part of our existing collections of information related to Regulations 14A and 14C. However, we subsequently submitted to OMB a PRA analysis based on revisions to the Regulation 14A and Regulation 14C collections. Although we did not revise our burden estimates associated with the Notice, the collection of information approved by OMB related to revisions to existing collections of information (Regulations 14A and 14C) and therefore we refer to those collections of information in this PRA discussion.

<sup>30</sup> Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

information requiring OMB's approval. Further, our preliminary estimate is that the one significant modification to the notice and access model we are proposing for the universal Internet availability model, the option to provide a full set of proxy materials with the Notice, does not require us to modify our burden estimates for the Regulation 14A and 14C collections of information. We solicit comment on the accuracy of our estimate that no additional recordkeeping or information collection requirements or changes to existing collection requirements would result from the proposed amendments.

## **VI. Cost-Benefit Analysis**

### **A. Background**

We are proposing revisions to the proxy rules under the Exchange Act to require issuers and other soliciting persons to follow the universal Internet availability model for furnishing proxy materials. The proposed amendments are intended to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications.

### **B. Summary of Proposals**

The proposals would provide a universal Internet availability model that would require issuers and other soliciting persons to furnish proxy materials by posting them on a specified, publicly-accessible Internet Web site (other than the Commission's EDGAR Web site) and providing shareholders with a notice informing them that the materials are available and explaining how to access them. Under this model, shareholders may request copies of the proxy materials from the issuer. Shareholders receiving a Notice from a soliciting person other than the issuer may also request copies from that person.

However, neither an issuer nor a soliciting person other than the issuer would have to provide copies on request if it chooses to send a full set of proxy materials, including the proxy statement, annual report (if required) and proxy card, with the Notice. The proposals also would require intermediaries to follow similar procedures to provide beneficial owners with access to the proxy materials.

### **C. Benefits**

Currently, issuers decide whether to provide shareholders with the choice to receive proxy materials by electronic means. The proposed amendments are intended to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of the Internet to lower the costs of proxy solicitations, and to improve shareholder communications. The proposed amendments, if adopted, would provide all shareholders with the ability to choose whether to receive proxy materials in paper, by e-mail or via the Internet. As technology continues to progress, accessing the proxy materials on the Internet should increase the utility of our disclosure requirements to shareholders. Information in electronic documents is often more easily searchable than paper documents. Users are better able to go directly to any section of the document that they believe to be the most important. They also permit users to more easily manipulate data and enter data into analytical tools such as spreadsheet programs. Such tools enable users to compare relevant data about several companies more easily.

In addition, encouraging shareholders to use the Internet in the context of proxy solicitations may encourage improved shareholder communications in other ways. Electronic innovations such as Internet chat rooms and bulletin boards may enhance shareholders' ability to communicate not only with management, but with each other.

Such direct access may improve shareholder relations to the extent shareholder feel that they have enhanced access to management. Centralizing an issuer's disclosure on a Web site may facilitate shareholder access to other important information, such as research reports and news concerning the issuer. We believe that migrating proxy disclosure to the Internet and uniform use of the Internet for that purpose could ultimately lower the cost of soliciting proxies for all issuers.

In terms of paper processing alone, the benefits of the rule amendments are limited by the volume of paper processing that would occur otherwise. As we note in the companion adopting release, Automatic Data Processing, Inc. (ADP) handles the vast majority of proxy mailings to beneficial owners.<sup>31</sup> ADP publishes statistics that provide useful background for evaluating the likely consequences of the rule amendments. ADP estimates that, during the 2006 proxy season,<sup>32</sup> over 69.7 million proxy material mailings were eliminated through a variety of means, including householding and existing electronic delivery methods. During that season, ADP mailed 85.3 million paper proxy items to beneficial owners. ADP estimates that the average cost of printing and mailing a paper copy of a set of proxy materials during the 2006 proxy season was \$5.64. We estimate that issuers and other soliciting persons spent, in the aggregate, \$481.2 million in postage and printing fees alone to distribute paper proxy materials to beneficial owners.<sup>33</sup> Approximately 50% of all proxy pieces mailed by ADP in 2005 were mailed during the

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<sup>31</sup> We expect savings per mailing to record holders to roughly correspond to savings per mailing to beneficial owners.

<sup>32</sup> According to ADP data, the 2006 proxy season extended from February 15, 2006 to May 1, 2006.

<sup>33</sup> 85.3 million mailings x \$5.64/mailing = \$481.2 million.

proxy season.<sup>34</sup> Therefore, we estimate that issuers and other persons soliciting proxies from beneficial owners spent approximately \$962.4 million in 2006 in printing and mailing costs.<sup>35</sup>

In the companion adopting release, we based our estimates on an assumption that issuers representing between 10% and 50% of proxy mailings would follow the notice and access model. Under our proposed universal Internet availability model, we estimate that the paper-related savings would be similar for firms that choose to mail full sets of proxy materials only to those investors who request them. Issuers that choose to mail full sets of proxy materials with the Notice would not realize any paper-related savings. Based on the assumption that 19% of shareholders would choose to have paper copies sent to them when an issuer relies on the notice and access model, we estimate that the proposal could produce annual paper-related savings ranging from \$48.3 million (if issuers who are responsible for 10% of all proxy mailings choose to mail proxy materials only to those who request them) to \$241.4 million (if issuers who are responsible for 50% of all proxy mailings choose to mail proxy materials only to those who request them).<sup>36</sup>

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<sup>34</sup> According to ADP, in 2005, 90,013,175 of 179,833,774, or 50%, of proxy pieces were mailed during the 2005 proxy season.

<sup>35</sup> \$481.2 million / 50% = \$962.4 million.

<sup>36</sup> This range of potential cost savings depends on data on proxy material production, home printing costs, and first-class postage rates provided by Lexecon and ADP, and supplemented with modest 2006 USPS postage rate discounts. The fixed costs of notice and proxy material production are estimated to be \$2.36 per shareholder. The variable costs of fulfilling a paper requests, including handling, paper, printing and postage, are estimated to be \$6.11 per copy requested. Assumptions about percentages of shareholders requesting paper copies are derived from Forrester survey data furnished by ADP and adjusted for the reported likelihood that an investor will take extra steps to get proxy materials. Our estimate of the total number of shareholders is based on data provided by ADP and SIA. According to SIA's comment letter, 78.49% of shareholders held their shares in street name. We estimate that the total number of proxy pieces mailed equals the number of pieces mailed to beneficial shareholders by ADP in 2005 divided by 78.49%, which equals 179,833,774 / 78.49%, or 229,116,797.

This estimate excludes the effect of the provision of the amendments that would allow shareholders to make a permanent request for paper copies. That provision would enable issuers and other soliciting persons to take advantage of bulk printing and mailing rates for those requesting shareholders, and therefore should reduce the on-demand costs reflected in these calculations.

We estimate that approximately 19% of shareholders would request paper copies. Commenters on the initial Internet availability proposal provided alternate estimates. For example, Computershare, a large transfer agent, estimated that less than 10% of shareholders would request paper copies.<sup>37</sup> According to a survey conducted by Forrester Research for ADP, 12% of shareholders report that they would always take extra steps to get their proxy materials, and as many as 68% of shareholders report that they would take extra steps to get their proxy materials in paper at least some of the time. The same survey also finds that 82% of shareholders report that they look at their proxy materials at least some of the time. These survey results suggest that shareholders may review proxy materials even if they do not vote. During the 2005 proxy season, only 44% of accounts were voted by beneficial owners. Put differently, 56%, or 84.8 million accounts, did not return requests for voting instructions. Our estimate that 19% of shareholders would request paper copies reflects the diverse estimates suggested by the available data.

Although we expect the savings to be significant, the actual paper-related benefits would be influenced by several factors that we estimate would become less important over time. First, to the extent that some shareholders request paper copies of the proxy materials, the benefits of the amendments in terms of savings in printing and mailing

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<sup>37</sup> See letter from Computershare.

costs would be reduced. Issuers are concerned that the cost per paper copy would be significantly greater if they have to mail copies of paper proxy materials to shareholders on an on-demand basis, rather than mailing the paper copies in bulk. Thus, if a significant number of shareholders request paper, the savings would be substantially reduced. Second, issuers may face a high degree of uncertainty about the number of requests that they may get for paper proxy materials and may maintain unnecessarily large inventories of paper copies as a precaution. As issuers gain experience with the number of sets of paper materials that they need to supply to requesting shareholders, and as shareholders become more comfortable with receiving disclosures via the Internet, the number of paper copies are likely to decline, as would issuers' tendency to print many more copies than ultimately are requested. This would lead to growth in paper-related savings from the rule amendments over time.

Additional benefits would accrue from reductions in the costs of proxy solicitations by persons other than the issuer. Under the proposal, persons other than the issuer also can rely on the notice and access model, but would be able to limit the scope of their proxy solicitations to shareholders who have not requested paper copies of the proxy materials. We expect that the flexibility afforded to persons other than the issuer under the proposal ultimately would reduce the cost of engaging in proxy contests, thereby increasing the effectiveness and efficiency of proxy contests as a source of discipline in the corporate governance process.

The effect of the amendments of lessening the costs associated with a proxy contest would be limited by the persistence of other costs. One commenter on the proposed voluntary model noted that a large percentage of the costs of effecting a proxy

contest go to legal, document preparation, and solicitation fees, while a much smaller percentage of the costs is associated with printing and distribution of materials.<sup>38</sup>

However, other commenters suggested that the paper-related cost savings that can be realized from the rule amendments are substantial enough to change the way many contests are conducted.<sup>39</sup>

Finally, some benefits from the proposal may arise from a reduction in what may be regarded as the environmental costs of the proxy solicitation process.<sup>40</sup> Specifically, proxy solicitation involves the use of a significant amount of paper and printing ink. Paper production and distribution can adversely affect the environment, due to the use of trees, fossil fuels, chemicals such as bleaching agents, printing ink (which contains toxic metals), and cleanup washes. To the extent that paper producers internalize these costs and the costs are reflected in the price of paper and other materials consumed during the proxy solicitation process, our dollar estimates of the paper-related benefits reflect the elimination of these adverse environmental consequences under the proposed amendments.

#### **D. Costs**

An issuer's compliance with the proposed model, if adopted, would introduce several new costs into the process of proxy distribution for issuers that otherwise would choose not to follow the notice and access model voluntarily and their shareholders, including the following: (1) the cost of posting proxy materials on an Internet Web site and providing a means to vote on that Web site; (2) the cost of preparing, producing, and

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<sup>38</sup> See letter from ADP.

<sup>39</sup> See letters from CALSTRS, Computershare, ISS, and Swingvote.

<sup>40</sup> See letter from American Forests.

sending the Notice to shareholders; (3) the cost of processing shareholders' requests for copies of the proxy materials and maintaining their permanent election preferences; and (4) the cost to shareholders of printing proxy materials at home that would otherwise be printed by issuers.

Under the proposed rules, issuers and other soliciting persons would be required to post their materials on an Internet Web site and provide a means to vote on that Web site. We believe the cost of obtaining a Web site and posting materials on it would be minimal to issuers and other soliciting persons. The rules do not require elaborate web site design. Posting a document on such a Web site and providing a means to vote, such as posting a telephone number on that Web site for voting, is a fairly simple and inexpensive process. We believe the costs of these requirements would be minimal.

A soliciting person, including an issuer, would be required to provide a means to vote on the Internet Web site. Although, as noted above, posting a telephone number on a Web site would impose minimal cost, the soliciting person would have to have a means for collecting those votes. Thus, at a minimum, the soliciting person would have to provide an automated system for collecting votes, either over the Internet or by telephone, or have people staffing telephones to receive the votes. We are soliciting comment on the cost of establishing such mechanisms for accepting votes. An issuer would also have to maintain records of shareholders who have requested paper or e-mail copies for all future solicitations. In the companion release adopting the voluntary notice and access model, we estimated that this cost to issuers and intermediaries would be approximately \$9,977,500.<sup>41</sup>

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<sup>41</sup> In that release, we estimated that issuers and intermediaries would spend a total of 79,820 hours of issuer and intermediary personnel time maintaining these records. We estimated

Under the proposed rules, intermediaries would be required to follow similar requirements as would issuers, including preparing Notices, providing a means to vote and maintaining records of shareholders who have requested paper or e-mail copies for future solicitations. We are soliciting comment on those costs as well.

As we stated in the companion adopting release, the paper-related savings to issuers and other soliciting persons discussed under the benefits section above are adjusted for the cost of printing and sending Notices. If Notices are sent by mail, then the mailing costs may vary widely among parties. Postage rates likely would vary from \$0.14 to \$0.39 per Notice mailed, depending on numerous factors. In our estimates of the paper-related benefits above, we assume that each Notice costs a total of \$0.13 to print and \$0.29 to mail. Based on data from ADP and SIA, we estimate that issuers and other soliciting persons send a total of 229,116,797 accounts processed per year.<sup>42</sup> In the companion release, we assume that only those firms that choose to adopt the notice and access model would incur these printing and mailing costs. Under the proposed universal Internet availability model, all issuers would be required to furnish each of its shareholders with a copy of the Notice. Firms that choose to mail full sets of proxy materials only to those investors who request them would incur the printing cost and cost of mailing the Notice separately from the proxy materials. Firms that choose to mail full sets of proxy materials with the Notice would incur the printing costs, but not the additional mailing cost. These printing costs represent the incremental cost of moving to

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the average hourly cost of issuer and intermediary personnel time to be \$125, resulting in a total cost of \$9,977,500 for issuer and intermediary personnel time. See Release No. 34-55146.

<sup>42</sup> See [www.ics.adp.com/release11/public\\_site/about/stats.html](http://www.ics.adp.com/release11/public_site/about/stats.html) stating that ADP handled 179,833,774 in fiscal year 2005 and letter from SIA stating that beneficial accounts represent 78.49% of total accounts.

universal Internet availability from the model in the companion adopting release. If issuers who are responsible for 10% of all current proxy mailings choose to mail full sets of proxy materials only to those investors who request them, the remaining 90% of issuers would incur of total cost of \$26.8 million to print the Notice. If issuers who are responsible for 50% of all current proxy mailings choose to mail full sets of proxy materials only to those investors who request them, the remaining 50% of issuers would incur of total cost of \$14.9 million to print the Notice.<sup>43</sup>

The universal Internet availability model also requires minimal added disclosures in the form of a Notice to shareholders, informing them that the proxy materials are available at a specified Internet Web site. In the companion adopting release, we assumed, for purposes of the PRA, that all issuers and other soliciting persons would elect to follow the procedures, resulting in a total estimated cost to prepare the Notice of approximately \$2,020,475.<sup>44</sup> Based on the percentage of issuers that we estimated would adopt the notice and access model, these costs could range between \$1,010,238 (if 50% of issuers adopted the notice and access model) and \$1,818,432 (if 10% of issuers adopted the notice and access model). The proposal also would require issuers and intermediaries to maintain records of shareholders who have requested paper and e-mail copies for future proxy solicitations. We estimate that this total cost to all issuers and

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<sup>43</sup>  $90\% \times 229,116,797 \times \$0.13 = \$26.8$  million;  $50\% \times 229,116,797 \times \$0.13 = \$14.8$  million; We assume that the additional cost of mailing the Notice together with the full set of proxy materials is negligible.

<sup>44</sup> In the companion adopting release, we estimated, for PRA purposes, that issuers would spend a total of \$897,975 on outside professionals to prepare this disclosure. We also estimated that issuers would spend a total of 8,980 hours of issuer personnel time preparing this disclosure. We estimated the average hourly cost of issuer personnel time to be \$125, resulting in a total cost of \$1,122,500 for issuer personnel time. This results in

intermediaries would be approximately \$9,977,500,<sup>45</sup> with an incremental cost due to the proposals of \$4,988,750 (if 50% of issuers adopted the notice and access model voluntarily), and \$8,977,500 (if 10% of issuers adopted the notice and access model voluntarily).

Issuers and their intermediaries would incur additional processing costs if the proposal is adopted. The proposal would require an intermediary such as a bank, broker-dealer, or other association to follow the proposed model if an issuer so requests. An intermediary that follows the proposed model would be required to prepare its own Notice to beneficial owners, along with instructions on when and how to request paper copies and the website where the beneficial owner can access his or her request for voting instructions. Since issuers reimburse intermediaries for their reasonable expenses of forwarding proxy materials and intermediaries and their agents already have systems to prepare and deliver requests for voting instructions, we do not expect the involvement of intermediaries in sending their Notices to significantly affect the costs associated with the proposal.

Under the proposed model, a beneficial owner would be required to request a copy of proxy materials from its intermediary. The costs of collecting and processing requests from beneficial owners may be significant, particularly if the intermediary receives the requests of beneficial owners associated with many different issuers that

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a total cost of \$2,020,475 for all issuers. The costs for posting the materials on a Web site are included in this calculation.

<sup>45</sup> In the companion adopting release, we estimated, for PRA purposes, that issuers and intermediaries would spend a total of 79,820 hours of issuer and intermediary personnel time maintaining these records. We estimated the average hourly cost of issuer and intermediary personnel time to be \$125, resulting in a total cost of \$9,977,500 for issuer and intermediary personnel time.

specify different methods of furnishing the proxy. We expect that these processing costs would be highest in the first year after adoption but would subsequently decline as intermediaries develop the necessary systems and procedures and as beneficial owners increasingly become comfortable with accessing proxy materials online. In addition, the proposal would permit a beneficial owner to specify its preference on an account-wide basis, which should reduce the cost of processing requests for copies. These costs are ultimately paid by the issuer.

Shareholders obtaining proxy materials online would incur any necessary costs associated with gaining access to the Internet. In addition, some shareholders may choose to print out the posted materials, which would entail paper and printing costs. We estimate that approximately 10% of all shareholders would print out the posted materials at home at an estimated cost of \$7.05 per proxy package. Based on these assumptions, the proposal is estimated to produce incremental annual home printing costs ranging from \$16 million (if issuers who are responsible for 10% of all current proxy mailings choose to mail full sets of proxy materials only to those investors who request them) to \$80 million (if issuers who are responsible for 50% of all current proxy mailings choose mail full sets of proxy materials only to those investors who request them).<sup>46</sup> Investors would have the option to incur no additional cost by either accessing the proxy materials online or requesting paper copies of the materials from the issuer.

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<sup>46</sup> This range of potential home printing costs depends on data provided by Lexecon and ADP. See letter from ADP. The Lexecon data was included in the ADP comment letter. To calculate home printing cost, we assume that 50% of annual report pages are printed in color and 100% of proxy statement pages are printed in black and white. The estimated percentage of shareholders printing at home is derived from Forrester survey data furnished by ADP and adjusted for the reported likelihood that an investor will take extra steps to get proxy materials. Total number of shareholders estimated as above based on data provided by ADP and SIA. See letters from ADP and SIA.

## **E. Request for Comments**

We seek comments and empirical data on all aspects of this Cost-Benefit

Analysis. Specifically, we ask the following:

- What savings would issuers and other soliciting persons realize if they are required to follow the proposed model? Of those savings, which would be one-time savings and which would be annual savings?
- What added costs would issuers and other soliciting persons incur if they are required to follow the proposed universal Internet availability model? Of those costs, which would be one-time costs and which would be annual costs?
- Are there any other one-time or annual costs or benefits that we should consider?
- Our estimates of the paper-related savings associated with universal internet availability are based on those in our companion adopting release. Are our assumptions about the relevant printing costs and mailing costs, reasonable? In particular, would smaller issuers expect to realize similar savings?
- What proportion of shareholders would be expected to request paper copies? What proportion of beneficial owners would likely request paper copies from intermediaries rather than from issuers? Are there any issuers for which a high rate of paper requests might be anticipated? If so, are there any means, such as surveying shareholder interest in paper copies, that may mitigate such costs?

- Which issuers would choose to mail full sets of proxy materials? Would some issuers mail full sets of proxy materials to some shareholders and notices to others? If so, what proportions of shareholders would be sent each?
- What is the typical cost for obtaining an Internet Web site and posting materials on that Web site? What is the typical cost for establishing an automated system for collecting votes or shareholder voting instructions through the Internet or by telephone? What would be the cost of staffing telephone lines to receive votes or voting instructions?
- Are there other viable means for providing a means to vote on an Internet Web site? If so, what are they, and what would be the cost of providing such voting means?
- What would be the cost of maintaining records of shareholders who have elected to receive paper or e-mail copies of proxy materials for future solicitations? Many issuers and intermediaries, or their agents, already have systems to maintain records of shareholders who have affirmatively consented to electronic delivery, and many intermediaries, or their agents, have systems to maintain records of beneficial owners who have objected to disclosure of their identity to issuers. Considering the fact that such entities already have systems designed to record shareholder preferences, what would the added cost be of maintaining records of shareholders who have elected to receive paper or e-mail copies of proxy materials in the future?

- What costs and benefits would intermediaries incur? Would all of these costs and benefits be passed on to issuers? Are there any one-time or annual costs for intermediaries that we should consider?
- What other benefits and costs would be associated with rules requiring compliance with the universal Internet availability model?

## **VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation**

Section 23(a)(2) of the Exchange Act<sup>47</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act<sup>48</sup> and Section 2(c) of the Investment Company Act of 1940<sup>49</sup> require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

In a companion release, we are adopting a substantially similar Internet availability model as a voluntary model. The proposed amendments would require all issuers and other soliciting persons to follow the universal Internet availability model for all proxy solicitations, other than those associated with business combination transactions. The proposed amendments are intended to provide all shareholders with the

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<sup>47</sup> 15 U.S.C. 78w(a)(2).

<sup>48</sup> 15 U.S.C. 78c(f).

<sup>49</sup> 15 U.S.C. 80a-2(c).

ability to choose the means by which they receive proxy materials, to expand use of the Internet to lower the costs of proxy solicitations, and to improve shareholder communications. Currently, issuers decide whether to provide shareholders with the choice to receive proxy materials by electronic means. The proposal, if adopted, would provide all shareholders with the ability to choose whether to receive proxy materials in paper, by e-mail or via the Internet. We believe that expanded use of electronic communications to replace current modes of disclosures on paper and physical mailings would increase the efficiency of the shareholder communications process. Use of the Internet permits technology developers to enhance a shareholder's experience with respect to such communications. It permits interactive communications at real-time speeds. Improved shareholder communications may improve relationships between shareholders and management. Retail investors may have easier access to management. In turn, this may lead to increased confidence and trust in well-managed, responsive issuers.

The proposal, if adopted, may have the effect of initially raising costs on issuers and other soliciting persons by requiring persons who otherwise would not have followed the model to follow it. The proposal may create other inefficiencies such as reducing shareholder voting participation and increased reliance on broker discretionary voting. We are considering these potential effects, but do not anticipate that they will be significant. Therefore, we are proposing the amendments, but also are requesting comment on these matters. We are also considering the effect of the proposal on competition and capital formation, including the effect that the proposals may have on industries servicing the proxy soliciting process. We do not anticipate any significant

effects on capital formation. We also anticipate that some companies whose business model is based on the dissemination of paper-based proxy materials may experience adverse competition effects from the proposal. The proposal may also promote competition among Internet-based information services. We request comment on those effects.

We request comment regarding the degree to which our proposed amendments would have competitively harmful effects on public companies, and how we could best minimize those effects. We also request comment on any disproportionate cross-sectional burdens among the firms affected by our proposals that could have anti-competitive effects. We also request comment on the effects that the proposed amendments would have on efficiency and capital formation.

#### **VIII. Initial Regulatory Flexibility Analysis**

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed revisions to the rules and forms under the Exchange Act that would require issuers and other persons soliciting proxies to follow the universal Internet availability model for all proxy solicitations except for those associated with a business combination transaction.

##### **A. Reasons for the Proposed Action**

The proposed amendments are intended to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications. We are concurrently issuing an adopting release that creates a voluntary model. We anticipate that increased usage of the model will enhance the

ability of investors to make informed decisions and ultimately to lower the costs of proxy solicitations.

## **B. Objectives**

Currently, issuers decide whether to provide shareholders with the choice to receive proxy materials by electronic means. The proposal, if adopted, would provide all shareholders with the ability to choose whether to receive proxy materials in paper, by e-mail or via the Internet. Developing technologies on the Internet should expand the ways in which required disclosures can be used by shareholders. Electronic documents are more easily searchable than paper documents. Users are better able to go directly to any section of the document that they believe to be the most important. They also permit users to more easily manipulate data. It enables users to more easily download data into spreadsheet or other analytical programs so that they can perform their own analyses more efficiently. A centralized Web site containing proxy-related disclosures may facilitate shareholder access to other relevant information such as research reports and news about the issuer.

In addition, encouraging shareholders to use the Internet in the context of proxy solicitations may have the side-effect of improving shareholder communications in other ways. Internet tools, such as chat rooms and bulletin boards, may enhance shareholders' ability to communicate not only with management, but with each other. Such direct access may improve shareholder relations to the extent shareholders have improved access to management.

### **C. Legal Basis**

We are proposing amendments to the forms and rules under the authority set forth in Sections 3(b), 10, 13, 14, 15, 23(a), and 36 of the Exchange Act, as amended, and Sections 20(a), 30, and 38 of the Investment Company Act, as amended.

### **D. Small Entities Subject to the Proposed Rules**

The proposals would affect issuers that are small entities. Exchange Act Rule 0-10(a)<sup>50</sup> defines an issuer to be a “small business” or “small organization” for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 2,500 public companies, other than investment companies, that may be considered small entities.

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>51</sup> Approximately 157 registered investment companies meet this definition. Moreover, approximately 53 business development companies may be considered small entities.

Paragraph (c)(1) of Rule 0-10 under the Exchange Act<sup>52</sup> states that the term “small business” or “small organization,” when referring to a broker-dealer, means a broker or dealer that had 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 §240.17a-5(d); and is not affiliated with any person (other than

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<sup>50</sup> 17 CFR 240.0-10(a).

<sup>51</sup> 17 CFR 270.0-10.

<sup>52</sup> 17 CFR 240.0-10(c)(1).

a natural person) that is not a small business or small organization. As of 2005, the Commission estimates that there were approximately 910 broker-dealers that qualified as small entities as defined above.<sup>53</sup> Small Business Administration regulations define “small entities” to include banks and savings associations with total assets of \$165 million or less.<sup>54</sup> The Commission estimates that the rules would apply to approximately 9,475 banks, approximately 5,816 of which could be considered small banks with assets of \$165 million or less.

We request comment on the number of small entities that would be impacted by our proposals, including any available empirical data.

#### **E. Reporting, Recordkeeping and Other Compliance Requirements**

The proposals would require all issuers, including small entities, to follow the universal Internet availability model. Under the proposed amendments, all issuer and intermediaries would be required to prepare and disseminate a Notice of Internet Availability of Proxy Materials. The required disclosure in the Notice is information that would be readily available to the issuer. Issuers also would be required to post the proxy materials on a publicly accessible Web site, and issuers and intermediaries would be required to provide a means to execute a proxy or provide voting instructions, as applicable, on an Internet Web site. Issuers and intermediaries would be required to provide copies of the proxy materials to requesting shareholders. Issuers and intermediaries also would be required to maintain records to keep track of those

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<sup>53</sup> These numbers are based on a review by the Commission’s Office of Economic Analysis of 2005 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

<sup>54</sup> 13 CFR 121.201.

shareholders who have made a permanent request for paper or e-mail copies. Issuers also may have to change their Web site and e-mail procedures to comply with the rules designed to safeguard addressing anonymity of persons accessing the Web site and misuse of shareholder e-mail addresses.

**F. Duplicative, Overlapping or Conflicting Federal Rules**

We believe that there are no rules that conflict with or duplicate the proposed rules.

**G. Significant Alternatives**

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;
- The clarification, consolidation or simplification of disclosure for small entities;
- The use of performance standards rather than design standards; and
- An exemption for small entities from coverage under the proposals.

The Commission has considered a variety of reforms to achieve its regulatory objectives.

The proposed amendments, if adopted, would require all issuers and intermediaries, including small entities, to follow the universal Internet availability model. We believe that in the long run, use of the Internet for shareholder

communications not only may decrease costs for all issuers, but also may improve the quality of shareholder communications by enhancing a shareholder's ability to search and manipulate proxy disclosures. However, in the short term, we are considering a tiered system of compliance dates to minimize the burdens on smaller issuers, including small entities. If we adopt tiered compliance dates, we do not anticipate that issuers other than large accelerated filers would be required to comply with the requirements until January 1, 2009. This would provide smaller issuers more time to adjust to the amendments and learn from the experiences of larger filers.

Intermediaries that are small entities would also be subject to the amendments, if they are adopted. We are considering whether such entities should be exempt from the amendments. Such an exemption may create disparity in the way shareholders receive proxy materials. Shareholders owning securities through such intermediaries would not have the ability to choose the means by which they receive proxy disclosures.

We considered the use of performance standards rather than design standards in the proposed rules. The proposal contains both performance standards and design standards. We are proposing design standards to the extent that we believe compliance with particular requirements are necessary. However, to the extent possible, we are proposing rules that impose performance standards to provide issuers, other soliciting persons and intermediaries with the flexibility to devise the means through which they can comply with such standards.

We are requesting comment on whether separate requirements for small entities would be appropriate. The purpose of the amendments is to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of

the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications. Exempting small entities would not be consistent with this goal. However, as noted above, we are considering providing more time for small entities to comply with the proposed requirements. The establishment of any differing compliance or reporting requirements or timetables or any exemptions for small business issuers may not be in keeping with the objectives of the proposed rules.

#### **H. Solicitation of Comment**

We encourage comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and
- How to quantify the impact of the proposed rules.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

#### **IX. Small Business Regulatory Enforcement Fairness Act**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,<sup>55</sup> a rule is “major” if it has resulted, or is likely to result in:

- An annual effect on the economy of \$100 million or more;

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<sup>55</sup> Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

- A major increase in costs or prices for consumers or individual industries;  
or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. 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.

#### **X. Statutory Basis and Text of Proposed Amendments**

We are proposing the amendments pursuant to Sections 3(b), 10, 13, 14, 15, 23(a), and 36 of the Securities Exchange Act of 1934, as amended, and Sections 20(a), 30, and 38 of the Investment Company Act of 1940, as amended.

#### **List of Subjects**

##### **17 CFR Part 240**

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

#### **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p,

78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

2. Amend §240.14a-7 by removing Note 3 to §240.14a-7.

3. Amend §240.14a-16 by:

a. Revising paragraphs (a), (e)(2)(i)(B), (e)(2)(ii), (f)(2)(i), (f)(2)(ii), (h), the introductory text of paragraph (l) and paragraph (l)(2);

b. Adding paragraphs (e)(2)(iii), (f)(2)(iii), (f)(2)(iv), and (j)(5); and

b. Removing paragraph (n).

The revisions and additions to read as follows:

**240.14a-16 Internet availability of proxy materials.**

(a)(1) A registrant shall furnish a proxy statement pursuant to §240.14a-3(a) and an annual report to security holders if required by §240.14a-3(b) to a security holder by sending the security holder a Notice of Internet Availability of Proxy Materials, as described in this section, 40 calendar days or more prior to the security holder meeting date, or if no meeting is to be held, 40 calendar days or more prior to the date that votes, consents or authorizations may be used to effect the corporate action, and complying with all other requirements of this section; provided, that if the registrant concurrently sends the Notice of Internet Availability of Proxy Materials with a copy of the proxy statement, annual report to security holders, if required pursuant to §240.14a-3(b), and form of proxy pursuant to paragraph (f)(3) of this section, the registrant need not comply with the timing requirements of this paragraph (a)(1).

(2) If the registrant knows that securities of any class entitled to vote at a meeting (or by written consents or authorizations if no meeting is held) with respect to which the registrant intends to solicit proxies, consents or authorizations are held of record by a broker, dealer, voting trustee, bank, association, or other entity that exercises fiduciary powers in nominee name or otherwise, the registrant must provide the record holder or respondent bank with all information listed in paragraph (d) of this section in sufficient time for the record holder or respondent bank to prepare and send a Notice to beneficial owners at least 40 calendar days before the meeting date; provided, that if the registrant provides the record holder or respondent bank with copies of the proxy statement and annual report to security holders, if required pursuant to §240.14a-3(b) pursuant to paragraph (f)(3) of this section, to be concurrently sent with the record holder's or respondent bank's Notice of Internet Availability of Proxy Materials, the registrant need not comply with the timing requirements of this paragraph (a)(2).

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(i) \* \* \*

(B) The registrant is not soliciting proxy or consent authority, but is furnishing an information statement pursuant to §240.14c-2;

(ii) The registrant may include a statement on the Notice to educate security holders that no personal information other than the identification or control number is necessary to execute a proxy; and

(iii) If the registrant concurrently sends the Notice of Internet Availability of Proxy Materials with a copy of the proxy statement, annual report to security holders, if required under §240.14a-3(b), and form of proxy pursuant to paragraph (f)(2)(iii) of this section, the Notice of Internet Availability of Proxy Materials need not contain:

(A) A legend relating to security holder requests for copies of the documents;  
and

(B) Instructions on how to request a copy of the documents.

(f) \* \* \*

(2) \* \* \*

(i) A pre-addressed, postage-paid reply card for requesting a copy of the proxy materials;

(ii) A copy of any notice of security holder meeting required under state law if that notice is not combined with the Notice of Internet Availability of Proxy Materials;

(iii) Any other type of security holder communications provided that such transmission includes all of the following documents:

(A) A copy of the proxy statement;

(B) A copy of the annual report to security holders if required by §240.14a-3(b); and

(C) A form of proxy; and

(iv) In the case of an investment company registered under the Investment Company Act of 1940, the company's prospectus or a report that is required to be transmitted to stockholders by section 30(e) of the Investment Company Act (15 U.S.C. 80a-29(e)) and the rules thereunder.

\* \* \* \* \*

(h) The registrant may send a form of proxy to security holders 10 calendar days or more after the date it first sent the Notice of Internet Availability of Proxy Materials to security holders if:

(1) The form of proxy is accompanied or preceded by a copy, via the same medium, of the proxy statement and any annual report to security holders that is required by §240.14a-3(b) pursuant to paragraph (f)(2)(iii) of this section, or

(2) The form of proxy is accompanied by a copy of the Notice of Internet Availability of Proxy Materials.

\* \* \* \* \*

(j) \* \* \*

(5) A registrant need not comply with paragraphs (j)(1) and (j)(2) of this section if it sends a copy of the proxy statement, annual report to security holders if required by §240.14a-3(b) and form of proxy pursuant to paragraph (f)(3)(ii) of this section.

\* \* \* \* \*

(l) A person other than the registrant soliciting proxies shall follow the requirements imposed on registrants by this section, provided that:

\* \* \* \* \*

(2) A soliciting person other than the registrant must send its Notice of Internet Availability of Proxy Materials by the later of:

(i) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date that votes, consents, or authorizations may be used to effect the corporate action; or

(ii) 10 calendar days after the date that the registrant first sends its proxy statement or Notice of Internet Availability of Proxy Materials to security holders; provided, that if the soliciting person other than the registrant concurrently sends the Notice of Internet Availability of Proxy Materials with a copy of the proxy statement and form of proxy pursuant to paragraph (f)(3) of this section, the soliciting person other than the registrant need not comply with the timing requirements of this paragraph (1)(2)

\* \* \* \* \*

4. Amend §240.14b-1 by:

- a. Revising the introductory text of paragraph (d); and
- b. Adding paragraph (d)(1)(iii).

The revision and addition read as follows.

**§240.14b-1 Obligation of registered brokers and dealers in connection with the prompt forwarding of certain communications to beneficial owners.**

\* \* \* \* \*

(d) Upon receipt from the soliciting person of all of the information listed in §240.14a-16(d), the broker or dealer shall:

(1) \* \* \*

(iii) The broker or dealer need not comply with the deadlines set forth in paragraphs (d)(1)(i) and (d)(1)(ii) of this section, if the registrant or other soliciting person provides the broker or dealer with copies of the proxy statement and annual report to security holders, if required pursuant to §240.14a-3(b), pursuant to §240.14a-

16(f)(3)(ii), to be concurrently sent with the broker's or dealer's Notice of Internet Availability of Proxy Materials.

\* \* \* \* \*

4. Amend §240.14b-2 by:
  - a. Revising the introductory text of paragraph (d); and
  - b. Adding paragraph (d)(1)(iii).

The revision and addition read as follows.

**§240.14b-2 Obligation of banks, associations and other entities that exercise fiduciary powers in connection with the prompt forwarding of certain communications to beneficial owners.**

\* \* \* \* \*

(d) Upon receipt from the soliciting person of all of the information listed in §240.14a-16(d), the bank shall:

(1) \* \* \*

(iii) The bank need not comply with the deadlines set forth in paragraphs (d)(1)(i) and (d)(1)(ii), if the registrant or other soliciting person provides the bank with copies of the proxy statement and annual report to security holders, if required pursuant to §240.14a-3(b), pursuant to §240.14a-16(f)(3)(ii), to be concurrently sent with the bank's Notice of Internet Availability of Proxy Materials.

\* \* \* \* \*

6. Amend §240.14c-2 by revising paragraph (d) to read as follows:

**§240.14c-2 Distribution of information statement.**

\* \* \* \* \*

(d) A registrant may transmit an information statement to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16; provided, however, that the registrant shall revise the information required in the Notice of Internet Availability of Proxy Materials, including changing the title of that notice, to reflect the fact that the registrant is not soliciting proxies for the meeting.

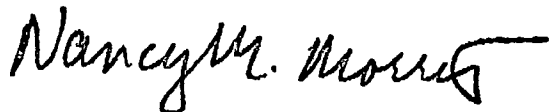
7. Amend §240.14c-3 by revising paragraph (d) to read as follows:

**§240.14c-3 Annual report to be furnished security holders.**

\* \* \* \* \*

(d) A registrant may furnish an annual report to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16.

By the Commission.

  
Nancy M. Morris  
Secretary

January 22, 2007

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 240, 249 and 274**

**[RELEASE NOS. 34-55146; IC-27671; File No. S7-10-05]**

**RIN 3235-AJ47**

**INTERNET AVAILABILITY OF PROXY MATERIALS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule; request for comment on Paperwork Reduction Act burden estimates.

**SUMMARY:** We are adopting amendments to the proxy rules under the Securities Exchange Act of 1934 that provide an alternative method for issuers and other persons to furnish proxy materials to shareholders by posting them on an Internet Web site and providing shareholders with notice of the availability of the proxy materials. Issuers must make copies of the proxy materials available to shareholders on request, at no charge to shareholders. The amendments put into place processes that will provide shareholders with notice of, and access to, proxy materials while taking advantage of technological developments and the growth of the Internet and electronic communications. Issuers that rely on the amendments may be able to significantly lower the costs of their proxy solicitations that ultimately are borne by shareholders. The amendments also might reduce the costs of engaging in a proxy contest for soliciting persons other than the issuer. The amendments do not apply to business combination transactions. The amendments also do not affect the availability of any existing method of furnishing proxy materials.

**DATES:** Effective Date: [insert date 60 days after publication in the Federal Register].

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Compliance Date: Persons may not send a Notice of Internet Availability of Proxy Materials to shareholders prior to July 1, 2007.

Comment Due Date: Comments on the Paperwork Reduction Act burden estimate 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/final.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-10-05 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 in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-10-05. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on its Internet Web site (<http://www.sec.gov/rules/final.shtml>). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from

submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Raymond A. Be, Special Counsel, Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are amending Rules 14a-2,<sup>1</sup> 14a-3,<sup>2</sup> 14a-4,<sup>3</sup> 14a-7,<sup>4</sup> 14a-8,<sup>5</sup> 14a-12,<sup>6</sup> 14a-13,<sup>7</sup> 14b-1,<sup>8</sup> 14b-2,<sup>9</sup> 14c-2,<sup>10</sup> 14c-3,<sup>11</sup> 14c-5,<sup>12</sup> 14c-7,<sup>13</sup> Schedule 14A,<sup>14</sup> Schedule 14C,<sup>15</sup> Form 10-K,<sup>16</sup> Form 10-KSB,<sup>17</sup> Form 10-Q,<sup>18</sup> and Form 10-QSB,<sup>19</sup> under the Securities Exchange Act of 1934<sup>20</sup> and Form N-SAR<sup>21</sup> under the

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<sup>1</sup> 17 CFR 240.14a-2.

<sup>2</sup> 17 CFR 240.14a-3.

<sup>3</sup> 17 CFR 240.14a-4.

<sup>4</sup> 17 CFR 240.14a-7.

<sup>5</sup> 17 CFR 240.14a-8.

<sup>6</sup> 17 CFR 240.14a-12.

<sup>7</sup> 17 CFR 240.14a-13.

<sup>8</sup> 17 CFR 240.14b-1.

<sup>9</sup> 17 CFR 240.14b-2.

<sup>10</sup> 17 CFR 240.14c-2.

<sup>11</sup> 17 CFR 240.14c-3.

<sup>12</sup> 17 CFR 240.14c-5.

<sup>13</sup> 17 CFR 240.14c-7.

<sup>14</sup> 17 CFR 240.14a-101.

<sup>15</sup> 17 CFR 240.14c-101.

<sup>16</sup> 17 CFR 249.310.

<sup>17</sup> 17 CFR 249.310a.

<sup>18</sup> 17 CFR 249.308a.

<sup>19</sup> 17 CFR 249.308b.

<sup>20</sup> 15 U.S.C. 78a et seq.

<sup>21</sup> 17 CFR 249.330 and 274.101.

Exchange Act and the Investment Company Act of 1940.<sup>22</sup> We also are adding new Rule 14a-16 under the Exchange Act.

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<sup>22</sup> 15 U.S.C. 80a-1 et seq.

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## **I. Introduction**

On December 8, 2005, we proposed amendments to update the proxy rules to take greater advantage of communications technology by supplementing the existing regulatory framework with an alternative “notice and access” proxy model that could reduce significantly the printing and mailing costs associated with furnishing proxy materials to shareholders.<sup>23</sup> Under the notice and access model that we proposed, an issuer would be able to satisfy its obligations under the Commission’s proxy rules by posting its proxy materials on a publicly-accessible Internet Web site (other than the Commission’s EDGAR Web site) and providing shareholders with a notice informing them that the materials are available and explaining how to access those materials. Under the proposal, an issuer relying on the model would be required to provide a requesting shareholder with a copy of the proxy materials in paper or by e-mail, at no charge to the

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<sup>23</sup> Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597]. For purposes of this release only, the term “proxy materials” includes proxy statements on Schedule 14A, proxy cards, information statements on Schedule 14C, annual reports to security holders required by Rules 14a-3 and 14c-3 of the Exchange Act, notices of shareholder meetings, additional soliciting materials, and any amendments to such materials. For purposes of this release, the term does not include materials filed under Rule 14a-12.

shareholder. We proposed that soliciting persons other than the issuer also would be able to rely on the notice and access model.

We received approximately 140 comment letters on the proposed notice and access model from a variety of interested parties, including issuers and their agents, shareholders, intermediaries and their agents, financial printers, manufacturers of mailing products, and academics. There was significant disagreement among the commenters regarding these key issues raised by the proposed model:

- The sufficiency of current Internet access among the U.S. population such that the proposed model would be desirable;<sup>24</sup>
- The effect that the proposed notice and access model might have on levels of proxy voting by shareholders;<sup>25</sup>
- The level of security and privacy on the Internet;<sup>26</sup>

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<sup>24</sup> See, for example, letters suggesting that current rates of Internet access are sufficient from American Bar Association (ABA), America's Community Bankers (ACB), Association of Ameritech SBC Retirees (SBC Retirees), Business Roundtable (BRT), Computershare Ltd. (Computershare), Proxinvest, Gary Tannahill, Hermes, Investment Company Institute (ICI), Securities Transfer Association (STA), and Sullivan & Cromwell. But also see, for example, letters from Association of BellTel Retirees (BellTel Retirees), Todd Collier, Joel Brown, James Davis, Donna Garal, Clark Green, Heather Harper, Frank Inman, William LaFollette, James Phipps, Beth Spletter, Megan Stroinski, and the United States Postal Service (USPS) suggesting that those rates are not sufficient.

<sup>25</sup> Some commenters believed that the proposed model might result in a decline in voting by shareholders. See, for example, letters from Automatic Data Processing, Inc. (ADP), James Angel, Timothy Buchman, State Board of Administration of Florida (Florida State Board), Fund of Stockowners Rights (Stockowners Rights), IR Web Report, and Securities Industry Association (SIA). However, other commenters believed the rules may increase shareholder voting by facilitating the voting process. See, for example, letters from AFL-CIO, Robert Atkinson, Institutional Shareholder Services (ISS), Proxinvest, and Society of Corporate Secretaries and Governance Professionals (SCSGP).

<sup>26</sup> See, for example, letters from James Angel, Todd Collier, James Davis, William LaFollette, Matthew McGuire, and USPS.

- The extent of potential savings to issuers and those conducting proxy contests that choose to rely on the proposed model;<sup>27</sup> and
- Whether the proposed model may make the proxy delivery system, particularly as it relates to beneficial owners holding in street name through their brokers or other intermediaries, too complex.<sup>28</sup>

Several commenters suggested revisions related to the proposed notice and access model, including the following:

- The proposed rules should allow a shareholder to make an election to receive paper copies of the proxy materials with respect to any future solicitations that would remain in place until subsequently revoked by the shareholder;<sup>29</sup>
- An issuer should have to make the proxy card available to shareholders through the same medium it uses to make the proxy statement available to them;<sup>30</sup>

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<sup>27</sup> See, for example, letters from ADP and Computershare.

<sup>28</sup> See letter from ABA.

<sup>29</sup> See letters from American Business Council (ABC), AFL-CIO, James Angel, CALSTRS, Florida State Board, Ohio Public Employees Retirement System (OPERS), San Diego City Employees' Retirement System (San Diego Retirement), SIA, William Sjostrom, Stocklein Law Group, Swingvote, and Paul Uhlenhop.

<sup>30</sup> See letters from ACB, AFL-CIO, Amalgamated Bank of LongView Funds (Amalgamated Bank), BellTel Retirees, Council of Institutional Investors (CII), Florida State Board, Carl Hagberg, International Brotherhood of Teamsters (Teamsters), National Retiree Legislative Network (NRLN), San Diego Retirement, and Swingvote.

- The Commission should review and simplify the proxy delivery system as a whole rather than addressing the issue of electronic delivery of proxy materials in isolation;<sup>31</sup> and
- The New York Stock Exchange (“NYSE”) should review its current schedule of maximum fees that its member firms may charge issuers to forward issuers’ proxy materials to beneficial owners.<sup>32</sup>

Although there was a mixed reaction to the proposal,<sup>33</sup> we believe that current levels of access to the Internet merit adoption of the notice and access model as an alternative to the existing proxy distribution system. In this regard, we note that more than 10.7 million beneficial shareholders already have given their affirmative consent to electronic delivery of proxy materials and approximately 87.8% of shares voted were voted electronically or telephonically during the 2006 proxy season.<sup>34</sup> Moreover, research submitted to us during the comment period indicates that approximately 80% of investors in the United States have access to the Internet in their homes, a greater percentage than we estimated at the proposing stage.<sup>35</sup> Several commenters expressed the view that the current level of Internet usage is sufficiently high to warrant adoption of

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<sup>31</sup> See, for example, letters from BRT, Committee of Concerned Shareholders (Concerned Shareholders), Computershare, Carl Hagberg, Mellon, and STA.

<sup>32</sup> See letters from BRT, Computershare, and SCSGP.

<sup>33</sup> It appeared that many commenters opposing adoption mistakenly believed that they would lose the ability to receive paper copies. Others objected to having to request paper copies under the notice and access model. See, for example, letters from Arthur Comings, Dave Few, George Liddell, Robert Link, and Chloris Wolski.

<sup>34</sup> According to data available on the Web site of ADP. See [www.ics.adp.com/release11/public\\_site/about/stats.html](http://www.ics.adp.com/release11/public_site/about/stats.html).

<sup>35</sup> See letter from ADP. At the proposing stage, we estimated that 75% of people in the United States had Internet access, but we did not have an estimate for the percentage of investors with Internet access.

the proposed notice and access model.<sup>36</sup> Although some commenters did not think that Internet access is sufficiently widespread, particularly among seniors,<sup>37</sup> to warrant implementation of the proposed model at this time,<sup>38</sup> the requirement that any shareholder lacking Internet access, or preferring delivery of a copy of the proxy materials, can make a permanent request to receive a copy of the proxy materials (and all future proxy materials) at no charge should substantially mitigate the concern about Internet access.

Therefore, we are adopting the proposal substantially as proposed. The final rules are intended to allow issuers and other soliciting persons to establish procedures that will promote use of the Internet as a reliable and cost-efficient means of making proxy materials available to shareholders. Among those shareholders who access the proxy materials electronically, the rules also may increase the use of the Internet for voting proxies. An issuer's or other soliciting person's election to follow the notice and access model will be voluntary.<sup>39</sup>

Under the final rules, as discussed in more detail below, an issuer may satisfy its obligation under the Commission's proxy rules to furnish proxy materials to shareholders in connection with a proxy solicitation by posting its proxy materials on a publicly-

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<sup>36</sup> See, for example, letters from ABA, ACB, BRT, Computershare, Hermes, ICI, Proxinvest, SBC Retirees, STA, Sullivan & Cromwell, and Gary Tannahill.

<sup>37</sup> See, for example, letters from American Association of Retired Persons (AARP), BellTel Retirees, Timothy Buchman, Todd Collier, NRLN, Printing Industries of America (PIA), Stockowners Rights, and Telephone Pioneers of America.

<sup>38</sup> See, for example, letters from BellTel Retirees, Joel Brown, Todd Collier, James Davis, Donna Garal, Clark Green, Heather Harper, Frank Inman, William Lafollette, James Phipps, Beth Spletter, Megan Stroinski, and USPS.

<sup>39</sup> In a companion release, the Commission is proposing to require issuers and other soliciting persons to follow a substantially similar model. See Release No. 34-55147.

accessible Internet Web site (other than the Commission's EDGAR Web site) and sending a Notice of Internet Availability of Proxy Materials ("Notice") to shareholders at least 40 calendar days before the shareholder meeting date indicating that the proxy materials are available and explaining how to access those materials.<sup>40</sup> Shareholders must have a means to execute a proxy as of the time on which the Notice is sent.<sup>41</sup> The Notice also must explain how a shareholder can request a copy of the proxy materials and how a shareholder can indicate a preference to receive a paper or e-mail copy of any proxy materials distributed under the notice and access model in the future. An issuer may not send a proxy card along with the Notice; however, 10 calendar days or more after sending the Notice, the issuer may send a proxy card to shareholders.<sup>42</sup> If an issuer chooses to send a proxy card without a copy of the proxy statement under this provision, a copy of the Notice must accompany the proxy card so that recipients will be notified again about the Web site on which the proxy statement is accessible. Finally, the notice

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<sup>40</sup> An issuer or other soliciting person also must continue to comply with Exchange Act Rules 14a-6 [17 CFR 240.14a-6] and 14c-5 [17 CFR 240.14c-5], which require the issuer or other soliciting person to file its proxy statement (or information statement) and additional soliciting material with the Commission. An issuer also must continue to comply with Exchange Act Rules 14a-3(c) [17 CFR 240.14a-3(c)] and 14c-3(b) [17 CFR 240.14c-3(b)], which require an issuer to submit copies of its annual report to security holders to the Commission. The rules that we are adopting in this release do not affect any current Commission filing requirement, except that an issuer or other soliciting person following the notice and access model would be required to file the Notice as additional soliciting material under Exchange Act Rule 14a-6(b) [17 CFR 240.14a-6(b)].

<sup>41</sup> As discussed in more detail in Section II.A.2 of this release, an issuer or any other soliciting person must provide a means for executing proxies available at the time the Notice is sent. It may not wait until it sends a paper or e-mail copy of the proxy card 10 calendar days or more after sending the Notice to provide shareholders with a means to execute a proxy.

<sup>42</sup> An issuer may send a proxy card to shareholders before the conclusion of the 10-day period if the proxy card is accompanied or preceded by a copy, via the same medium, of the proxy statement and annual report to security holders if required by Rule 14a-3(b).

and access model may not be used in conjunction with a proxy solicitation related to a business combination transaction.

Shareholders and other persons conducting their own proxy solicitations may rely on the notice and access model under requirements substantially similar to the requirements that would apply to issuers. As a result, these rules may have the effect of reducing the cost of engaging in a proxy contest. However, unlike the requirements for an issuer, a soliciting person other than the issuer may selectively choose the shareholders from whom it desires to solicit proxies without the need to send an information statement to all other shareholders.

The new rules do not affect the availability of other means of providing proxy materials to shareholders, such as obtaining affirmative consents for electronic delivery pursuant to existing Commission guidance.<sup>43</sup> Thus, an issuer may rely on affirmative consents to furnish proxy materials to some shareholders, and rely on the notice and access model to furnish the materials to others.

We are making several significant revisions to the proposed notice and access model in response to commenters' concerns. First, the final rules do not permit a proxy card to accompany the Notice as we originally proposed, although the rules do permit an

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<sup>43</sup> Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458] (the "1995 Interpretive Release") provided guidance on electronic delivery of prospectuses, annual reports to security holders and proxy solicitation materials under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*], the Securities Exchange Act of 1934, and the Investment Company Act of 1940. Release No. 33-7288 (May 9, 1996) [61 FR 24644] (the "1996 Interpretive Release") provided guidance on electronic delivery of required information by broker-dealers and transfer agents under the Securities Act, the Exchange Act, and the Investment Company Act. Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843] (the "2000 Interpretive Release") provided guidance on the use of electronic media to deliver documents under the federal securities laws, an issuer's liability for Web site content, and basic legal principles that issuers and market intermediaries should consider in conducting online offerings.

issuer or other soliciting person to send a proxy card 10 calendar days or more after it sends the Notice, provided that a copy of the Notice or accompanies the proxy card.<sup>44</sup>

Second, we are adopting a requirement that issuers and other soliciting persons send the Notice to shareholders at least 40 calendar days before the shareholder meeting date, rather than 30 calendar days before the meeting, as proposed. We are making this change so that issuers and other soliciting persons will still have at least a 30-day period in which they can send a proxy card to shareholders if they choose to do so.

Third, in addition to the proposed requirement that a shareholder be able to request a paper or e-mail copy of the proxy materials for a particular meeting, the final rules require an issuer to allow shareholders to elect to receive paper or e-mail copies of proxy materials that the issuer will distribute in the future in reliance on the notice and access model. Similarly, intermediaries must allow beneficial owners to elect to receive paper or e-mail copies of any proxy materials that will be distributed in the future in reliance on the notice and access model with respect to all securities held in the beneficial owner's account. Fourth, under the new rules, an intermediary must prepare its own Notice for distribution to beneficial owners.

Fifth, the intermediary's Notice sent to a beneficial owner will direct the owner to request paper or e-mail copies from his or her intermediary, rather than from the issuer. Finally, the final rules do not permit soliciting persons other than the issuer to engage in a conditional solicitation as proposed and, therefore, the rules require such persons to send

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<sup>44</sup> An issuer or other soliciting person may, in the course of a solicitation, send several proxy cards to a shareholder. Under the notice and access model, the Notice must accompany each proxy card sent to a shareholder unless the issuer or other soliciting person sends a proxy statement with, or before, the proxy card and by the same medium as the proxy card is sent.

a copy of the proxy materials upon request from a shareholder to whom they have sent a Notice.

## **II. Description of the Amendments**

### **A. The Notice and Access Model for Issuers**

The notice and access model that we are adopting provides an alternative means for an issuer to furnish proxy materials to its shareholders. These proxy materials include:

- notices of shareholder meetings;
- Schedule 14A proxy statements and consent solicitation statements;
- forms of proxy (i.e., proxy cards);
- Schedule 14C information statements;
- annual reports to security holders;<sup>45</sup>
- additional soliciting materials;<sup>46</sup> and
- any amendments to such materials that are required to be furnished to shareholders.

In the proposing release, we sought comment on whether reliance on the notice and access model should be limited to particular types of issuers, shareholders, or transactions. The only restriction that we proposed was that the rules should not apply to

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<sup>45</sup> The requirement in Exchange Act Rules 14a-3(b) and 14c-3(a) to furnish annual reports to security holders does not apply to registered investment companies [17 CFR 240.14a-3(b) and 240.14c-3(a)]. The rules that we are adopting do not apply to the requirement in Section 30(e) of the Investment Company Act of 1940 [15 U.S.C. 80a-29(e)] and the rules thereunder that every registered investment company transmit reports to shareholders at least semi-annually.

<sup>46</sup> Our rules permit, but do not require, delivery of additional soliciting materials. See Rule 14a-6(b).

business combination transactions. Commenters in favor of the notice and access model generally supported broad availability of the notice and access model.<sup>47</sup> Therefore, the new rules permit any issuer to use the notice and access model to disseminate its proxy materials to all types of shareholders, whether registered or beneficial owners, and with respect to any solicitation except those related to business combination transactions.

#### **1. Notice of Internet Availability of Proxy Materials**

To notify shareholders of the availability of the proxy materials on an Internet Web site, an issuer relying on the notice and access model must send a Notice to shareholders 40 calendar days<sup>48</sup> or more in advance of the shareholder meeting date or, if no meeting is to be held, 40 calendar days or more in advance of the date that consents or authorizations may be used to effect the corporate actions.<sup>49</sup> We believe that it is important for the Notice to be furnished in a way that brings it to each shareholder's attention. Therefore, no other materials may accompany the Notice except for the notice of a shareholder meeting required under state corporation law.<sup>50</sup> An issuer also may combine the Notice with the state law notice unless state law prohibits such combination.

We have extended the proposed 30-day deadline for delivery of the Notice to a 40-day deadline to provide issuers with time to encourage shareholders who have not

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<sup>47</sup> See, for example, letters from ABC, ACB, Association of Corporate Counsel (ACC), Proxinvest, SCSGP, STA, and Sullivan & Cromwell.

<sup>48</sup> For purposes of determining this 40-day period under the new rules, the first day of this period would be the day on which the issuer sends the Notice. The 40th day would be the day prior to the meeting date or date of the corporate action.

<sup>49</sup> The Notice could be sent electronically to shareholders who have previously provided affirmative consent, or other evidence to show delivery, pursuant to our earlier guidance on electronic delivery. See the 1995 Interpretive Release and the 2000 Interpretive Release.

<sup>50</sup> The rules also permit a reply card for requesting a paper or e-mail copy of the proxy materials to accompany the Notice.

executed a proxy to participate in the voting process and to provide shareholders with sufficient time to receive the Notice, request copies of the materials, if desired, and review the proxy materials prior to executing a proxy. Under the new rules, an issuer may send a proxy card 10 calendar days or more after sending the Notice. If an issuer chooses to send a proxy card under this provision, a proxy statement and annual report need not accompany the proxy card.<sup>51</sup> However, if a copy of the proxy statement and annual report do not accompany or precede the proxy card, a copy of the Notice must accompany the proxy card so that shareholders can access the specified Web site without referring to the earlier Notice. This 10-day waiting period is designed to provide shareholders with sufficient time to access the proxy materials, or request a copy of the proxy materials, before the issuer sends a proxy card without an accompanying proxy statement and annual report.

If an issuer chooses to follow the notice and access model, the Notice of Internet Availability of Proxy Materials must include the following information in clear and understandable terms.<sup>52</sup>

- A prominent legend in bold-face type that states:  
  
**“Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].**
- **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the**

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<sup>51</sup> Of course, an issuer still would be obligated to send a copy of the proxy statement and annual report if a shareholder requests a copy. An issuer also may send a proxy card before the end of the 10-day period if it is accompanied by the proxy statement and annual report.

<sup>52</sup> Appropriate changes must be made to the Notice if the issuer is providing an information statement pursuant to Regulation 14C or seeking to effect a corporate action by written consent.

**important information contained in the proxy materials before voting.**

- **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**
- **If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery.”**
- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on and the issuer’s recommendations regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- (1) A toll-free telephone number; (2) an e-mail address; and (3) an Internet Web site address where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the Notice relates;
- Any control/identification numbers that the shareholder needs to access his or her proxy card;
- Instructions on how to access the proxy card, provided that such instructions do not enable a shareholder to execute a proxy without having access to the proxy statement and annual report; and

- Information on how to obtain directions to be able to attend the meeting and vote in person.

In response to commenters, we have added certain items to this list of permissible Notice information. First, we are clarifying that the Notice must contain instructions on how to access the proxy card. Such information should include any control or identification numbers necessary for the shareholder to execute a proxy, but may not include a means to execute a proxy, such as a telephone number, which would enable the shareholder to execute a proxy without having access to the proxy statement and annual report.

A shareholder's execution of a proxy via an Internet voting platform indicates that the shareholder has access to the Internet and, as such, is able to access the proxy materials electronically under the new rules. Similarly, if a shareholder executes a proxy via a telephone number placed on the Internet Web site which provides electronic access to the proxy materials, that indicates the shareholder has access to the Internet. However, if a telephone number for executing a proxy is placed on the Notice, there can be no assurance that a shareholder executing a proxy by means of that telephone number has access to the Internet Web site. Accordingly, placing such a telephone number on the Notice is not permitted. A telephone number for executing a proxy may, however, be provided on a proxy card sent to shareholders 10 calendar days or more after the Notice was sent because, by that time, a shareholder is likely to have had sufficient time to access the materials on the Internet or request copies.

Also, in response to comments, we have revised the rules to require an issuer or other soliciting person to include instructions in the Notice about: (1) how a shareholder

can request delivery of copies of proxy materials in paper or by e-mail in the future;<sup>53</sup> and (2) how to attend the shareholder meeting and vote in person. The new rules also require the Notice to include an Internet Web site on which a shareholder can request a copy of the proxy materials, in addition to a toll-free telephone number and an e-mail address for that purpose.

The Notice may include only the information specified above, unless it is being combined with the state law meeting notice, in which case any information required by state law also may be included in the Notice. While not required, to reduce the chance of parties creating false Notices to extract confidential information from shareholders, the Notice also may contain a statement advising shareholders that they are not required to provide any personal information, other than the identification or control number provided in the Notice (if such a number is used), to execute a proxy.

To ensure that the Notice is clear and understandable, it must meet substantially the same plain English principles as apply to key sections of Securities Act prospectuses pursuant to Securities Act Rule 421(d).<sup>54</sup> Both commenters remarking on the plain English aspect of the proposal supported such a requirement.<sup>55</sup>

Several commenters recommended that issuers should be able to include more information in the Notice than we proposed. They suggested that the rules should allow the Notice to incorporate information from the proxy statement and annual report that those commenters believe is the most important information contained in those documents. They believed that presenting this information on the Notice would enable

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<sup>53</sup> See letters from ABA, Mellon Investor Services (Mellon), and SCSGP.

<sup>54</sup> 17 CFR 230.421(d).

<sup>55</sup> See letters from Florida State Board and Proxinvest.

shareholders to make an informed decision based on the Notice alone.<sup>56</sup> We believe that the proxy statement and annual report to security holders represent the information necessary to make an informed voting decision. The Notice is intended merely to make shareholders aware that these proxy materials are available on an Internet Web site; it is not intended to serve as a stand-alone basis for making a voting decision. Because the disclosures in the proxy statement and annual report represent the information necessary for a voting decision, we do not believe it is appropriate to permit issuers and other soliciting persons to present only selected information from the proxy statement or annual report to security holders in the Notice.

The form of the Notice will constitute other soliciting material that the issuer or other soliciting person must file with the Commission pursuant to Rule 14a-6(b)<sup>57</sup> no later than the date on which it is first sent or given to shareholders.<sup>58</sup>

**a.     Householding**

Consistent with the proposal, the final rules permit an issuer to “household” the Notice pursuant to Rule 14a-3(e).<sup>59</sup> Accordingly, an issuer could send a single copy of the Notice to one or more shareholders residing at the same address if the issuer satisfies all of the Rule 14a-3(e) conditions.<sup>60</sup> An issuer is not required to re-solicit specific

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<sup>56</sup> See letters from Carl Hagberg, Hermes, and James Reed. For example, one commenter suggested that each proposal be accompanied by the “pros and cons” associated with that proposal. See letter from James Reed. Another commenter recommended that the president’s letter, Management’s Discussion and Analysis and selected financial information be included. See letter from Carl Hagberg.

<sup>57</sup> 17 CFR 240.14a-6(b).

<sup>58</sup> See Rule 14a-16(i) [17 CFR 240.14a-16(i)].

<sup>59</sup> 17 CFR 240.14a-3(e).

<sup>60</sup> If the Notice is sent via e-mail, the householding rules do not permit the sending of only one copy of the Notice to all shareholders in the household. Instead the Notice must be

consent regarding the householding of the Notice from shareholders if it has obtained their consent to householding of proxy materials in the past. However, an issuer following the notice and access model must allow each householded account to execute separate proxies. Therefore, the issuer must provide separate identification or control numbers, if it uses such numbers, to each account at the shared address, as required by the current householding rule.<sup>61</sup> Alternately, an issuer also may send separate Notices for each householded account in a single envelope. Commenters generally supported this aspect of the proposal.<sup>62</sup>

**b. Security and Privacy on the Internet**

Several commenters were concerned about security and confidentiality of shareholder information that may be transmitted over the Internet.<sup>63</sup> We believe that the final rules ameliorate many of these concerns. We address those concerns below.

**i. Theft of Identification or Control Numbers**

Some commenters were concerned that computer hackers may use any identifying information sent to shareholders to access their accounts.<sup>64</sup> The Notice may contain identification or control numbers for executing proxies or providing voting instructions, if

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separately e-mailed to each shareholder. See Rule 14a-3(e)(1)(ii)(B)(4) [17 CFR 240.14a-3(e)(1)(ii)(B)(4)].

<sup>61</sup> Issuers also are required to share a listing of the shareholders that have consented to householding with soliciting shareholders, or afford the benefit of such consents to a soliciting shareholder if the issuer is mailing proxy materials on the shareholder's behalf. See Rule 14a-7(a)(2) [17 CFR 240.14a-7(a)(2)].

<sup>62</sup> See letters from BRT, Computershare, Proxinvest, and SCSGP.

<sup>63</sup> See, for example, letters from James Angel, Todd Collier, James Davis, William LaFollette, Matthew McGuire, and USPS.

<sup>64</sup> Record holders could not be subject to such manipulation because they do not hold their securities in a trading account with the company in the same sense as beneficial owners hold their securities in a brokerage account.

an issuer or intermediary uses such numbers. We understand that these numbers, which are in common use today, usually provide the user only with access to execute proxies or provide voting instructions; they do not enable the user to buy or sell securities in a shareholder's account or transfer funds from that account. Thus, more sensitive activities, such as trading securities or transferring funds, could not be performed by someone who has stolen this identifying information. Finally, we note that 85% of shares voted already are voted electronically using such identification or control numbers.

ii. **"Phishing"**

One commenter expressed concern that, if Notices are sent electronically, shareholders may be tricked into disclosing personal information to persons fraudulently purporting to be issuers or intermediaries by fake "phishing" e-mails purporting to be official Notices, but designed to extract personal information from a shareholder.<sup>65</sup> We do not believe that the rules would provide significant opportunity for abuse through phishing for the following reasons.

First, an issuer may send a Notice by e-mail only if the shareholder has affirmatively consented to such delivery. Second, the Notice is not permitted to request any confidential information from the shareholder. Rather, the only confidential information that a shareholder must provide to access the proxy card would be a confidential identification or control number used by many issuers and intermediaries to track votes. As noted above, this number does not provide access to a shareholder's brokerage or bank account or permit the transfer of funds from a shareholder's account. Therefore, the shareholder's account number and other personal financial information

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<sup>65</sup> See letter from William LaFollette.

would not be in jeopardy of being stolen. The rules do permit an issuer or other soliciting person to include on the Notice a protective warning to shareholders, advising them that no personal information other than the identification or control number is necessary to execute a proxy.<sup>66</sup>

**iii. Misuse of Information by Issuers and Other Soliciting Persons**

Other commenters were concerned that issuers themselves, or other soliciting persons, may use shareholder information inappropriately. For example, they were concerned that an issuer may use shareholders' e-mail addresses for purposes other than proxy communications, such as advertising, or sell the e-mail addresses to third parties.<sup>67</sup> As a protective measure, one commenter suggested that the Internet Web site on which the proxy statement is posted should not require installation of cookies on the shareholder's computer as a prerequisite for access to the Web site.<sup>68</sup>

We agree that shareholder information gathered under the amended rules should be used only for the purposes of furnishing proxy materials to shareholders. Thus, we have revised the final rules to clarify that an issuer or its agent must maintain the Internet Web site on which the proxy materials are posted in a manner that does not infringe on the anonymity of a shareholder accessing that Web site.<sup>69</sup> For example, it may not track the identity of persons accessing that Web site to view the proxy statement.<sup>70</sup> In addition,

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<sup>66</sup> See Rule 14a-16(f)(3) [17 CFR 240.14a-16(f)(3)].

<sup>67</sup> See letter from Thomas Richardson.

<sup>68</sup> See letter from Bowne & Co.

<sup>69</sup> See Rule 14a-16(k)(1) [17 CFR 240.14a-16(k)(1)].

<sup>70</sup> Of course, the issuer would be permitted to track the identity, by means of the shareholder entering an issuer-provided control/identification number, of persons voting on an electronic platform in order to validate the election results.

the Web site cannot require the installation of any “cookies” or other software that might collect information about the accessing person. Further, the issuer and its agents may not use any e-mail address obtained from a shareholder for the purpose of requesting a copy of proxy materials for any purpose other than to send a copy of those materials to that shareholder. Finally, an issuer may not transfer a shareholder’s e-mail address to other persons without the shareholder’s express consent, except in connection with the distribution of proxy materials, such as an agent handling the proxy distribution on the issuer’s behalf.<sup>71</sup>

## **2. Proxy Card**

Under the notice and access model that we are adopting, an issuer is not permitted to furnish the proxy card together with the initial Notice for a particular solicitation. An issuer following the notice and access model must post the proxy card on the Web site with the proxy statement and any annual report no later than the time at which the Notice is sent to shareholders so that the documents are electronically available at the time shareholders receive the Notice.<sup>72</sup> In addition, on that Web site, the issuer must concurrently provide shareholders with at least one method of executing a proxy vote.<sup>73</sup> We believe that a shareholder who accesses proxy materials on the Internet Web site should be able to execute a proxy as soon as the shareholder is able to electronically access the proxy statement. An issuer may provide a means to execute a proxy through a variety of methods, including by providing an electronic voting platform linked to the

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<sup>71</sup> See Rule 14a-16(k)(2) [17 CFR 240.14a-16(k)(2)]. Rule 14a-16(k) is not designed to create new duties in private rights of action under the federal securities laws.

<sup>72</sup> See Rule 14a-16(b)(1) [17 CFR 240.14a-16(b)(1)].

<sup>73</sup> See Rule 14a-16(b)(4) [17 CFR 240.14a-16(b)(4)].

Web site where the proxy materials are posted or a telephone number for executing a proxy. Merely providing a shareholder with a means to request a paper proxy card would not be sufficient because a shareholder would not be able to execute a proxy at the time it accesses the proxy materials.

We received a significant number of comments on the aspect of our proposal that would have permitted the proxy card to accompany the Notice. Numerous commenters were concerned that physically separating the card from the proxy statement, as originally proposed, may lead to the type of uninformed voting that the proxy rules are intended to prevent.<sup>74</sup> Some commenters were concerned that issuers may attempt to structure their solicitations in a manner that discourages access to the proxy statement, particularly with respect to shareholder proposals.<sup>75</sup> Others, however, believed that separating the card from the proxy statement would not lead to such problems.<sup>76</sup>

We note these concerns and have revised the rules to require the proxy card to be accessible on the Internet along with the proxy statement and any annual report when the Notice is sent. The issuer may not send a proxy card with its initial Notice. However, we recognize that an issuer may wish to undertake subsequent soliciting activities to encourage shareholders who have not executed a proxy to do so. Currently, issuers often send replacement proxy cards accompanied by additional soliciting materials to shareholders who have not yet voted. To facilitate this re-solicitation process, the rules

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<sup>74</sup> See, for example, letters from ACB, AFL-CIO, Amalgamated Bank, BellTel Retirees, CIL, Florida State Board, Carl Hagberg, NRLN, San Diego Retirement, Swingvote, and Teamsters.

<sup>75</sup> See, for example, letters from AFL-CIO, Florida State Board, and Teamsters.

<sup>76</sup> See, for example, letters from ABA, ACC, BRT, Computershare, ISS, New York State Bar Association (NY State Bar), and Proxinvest.

permit an issuer that is following the notice and access model to send a proxy card 10 calendar days or more after sending the Notice. This 10-day waiting period still provides a 30 day period during which an issuer can encourage shareholders to execute a proxy. Any such subsequent solicitation efforts may, but need not, include a copy of the proxy statement and any annual report to security holders. However, if the subsequent communication includes a proxy card, it also must include either a copy of the proxy statement and any annual report or a copy of the Notice.<sup>77</sup>

### **3. Internet Web Site Posting of Proxy Materials**

All proxy materials to be furnished through the notice and access model, other than additional soliciting materials, must be posted on a specified Internet Web site by the time the issuer sends the Notice to shareholders.<sup>78</sup> These materials must remain on that Web site and be accessible to shareholders through the conclusion of the related shareholder meeting, at no charge to the shareholder. As discussed above, the Notice must identify clearly the Internet Web site address at which the proxy materials are available. The Internet Web site address must be specific enough to lead shareholders directly to the proxy materials,<sup>79</sup> rather than to the home page or other section of the Web Site on which the proxy materials are posted, so that shareholders do not have to browse the Web site to find the materials. The Internet Web site that an issuer uses to electronically furnish its proxy materials to shareholders must be a publicly accessible

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<sup>77</sup> See Rule 14a-16(h) [17 CFR 240.14a-16(h)].

<sup>78</sup> Additional soliciting materials used after the Notice is sent must be posted on the specified Web site no later than the day on which those materials are first sent or given to shareholders.

<sup>79</sup> This Web site could be a central site with prominent links to each of the proxy-related disclosure documents listed in the Notice, as well as proxy materials posted on the Web site after the Notice is sent.

Internet Web site other than the Commission's EDGAR Web site.<sup>80</sup> Commenters agreed that simply providing a link to the proxy materials on EDGAR was insufficient.<sup>81</sup>

Commenters were divided with respect to the type of document format that issuers or other soliciting persons should be required to use to post proxy materials on the Web site. This disagreement centered on whether most shareholders would prefer to be able to print out the document and read the hard copy version or read the document online. The final rules require the electronically posted proxy materials to be presented on the Internet Web site in a format, or formats, convenient for both printing and viewing online.<sup>82</sup> Under technology commonly in use today, this may require posting the materials in two different formats. First, the materials should be posted in a format that provides a version of those materials, including all charts, tables, graphics, and similarly formatted information, that is substantially identical to the paper version of the materials.

In addition, to take better advantage of the capabilities of the Internet, the materials also must be presented in a readily searchable format, such as HTML. This type of format would make the proxy materials easier to read on a computer screen. In addition, such a version may incorporate additional user-friendly features such as hyperlinks from a table of contents to enable shareholders to quickly and easily navigate through the document. Many Internet Web sites today provide documents in dual

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<sup>80</sup> An issuer must continue to comply with Rules 14a-6 and 14c-5, which require the soliciting person to file its proxy statement (or information statement) and additional soliciting material with the Commission. An issuer also must continue to comply with Rules 14a-3(c) and 14c-3(b), which require an issuer to submit copies of its annual report to security holders to the Commission. The issuer must comply with these requirements by the time it posts the materials on the Web site.

<sup>81</sup> See letters from James Angel, SCSGP, and Swingvote.

<sup>82</sup> See Rule 14a-16(c) [17 CFR 240.14a-16(c)].

formats such as this. We believe this requirement will impose minimal burden on issuers. We also believe that, as technology progresses, new formats may be developed that will improve shareholders' ability to print copies and read copies on their screens. Finally, to the extent a shareholder may need additional software to view the document, the Web site must contain a link to enable the shareholder to obtain the software free of charge.<sup>83</sup>

#### **4. Period of Reliance**

The decision by an issuer or other soliciting person to follow the notice and access model is effective only with respect to a particular meeting. An issuer's choice to rely on the notice and access model for one meeting therefore does not affect its determination of whether to rely on the model for subsequent meetings.<sup>84</sup> Similarly, a shareholder that does not request a paper or e-mail copy of the proxy materials for one meeting is not bound by that decision with respect to any other shareholder meeting. Each time an issuer chooses to rely on the notice and access model for a shareholder meeting, it must comply anew with all of the requirements under that model, including delivery of the Notice and the 40-day notice period.

We are adopting one important exception to this general principle. Numerous commenters were concerned that a shareholder desiring a paper or e-mail copy would have to request such a copy every year from each issuer in which he or she owns

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<sup>83</sup> See the 1995 Interpretive Release No. 33-7233, at n. 24 and the accompanying text; Release No. 33-8128 (Sep. 16, 2002) [67 FR 58480]; Release No. 33-8230 (May 7, 2003) [68 FR 25788]; and Release No. 33-8518 (Dec. 22, 2004) [70 FR 1505].

<sup>84</sup> To the extent the Commission adopts the universal Internet availability model in companion Release 34-55147, this option will no longer be available to issuers.

securities.<sup>85</sup> We agree with commenters that this could be unduly burdensome for a shareholder who owns numerous securities. The commenters recommended that a provision be made that permits a shareholder to make a single election to receive a paper or e-mail copy of the proxy materials on a continuing basis in the future. We agree with those commenters and have revised the rules to enable shareholders to make a permanent election to receive paper or e-mail copies from each issuer.<sup>86</sup>

## **5. State Law Notices**

State business and corporation laws typically set forth shareholder meeting requirements, including meeting notice and voting requirements. The new rules are not intended to affect any applicable state law requirement concerning the delivery of any document related to a shareholder meeting or proxy solicitation. Thus, to the extent that state law requires a notice of shareholder meeting and proxy materials to be delivered by a particular means, the rules do not alter those requirements.<sup>87</sup> For example, if the state in which an issuer is incorporated requires notices of shareholder meetings and proxy materials to be transmitted directly to shareholders in paper, the notice and access model

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<sup>85</sup> See, for example, letters from ABC, AFL-CIO, James Angel, CALSTRS, Florida State Board, OPERS, San Diego Retirement, SIA, William Sjostrom, Stocklein Law Group, Swingvote, and Paul Uhlenhop.

<sup>86</sup> A shareholder that elects to receive paper or e-mail copies may, in the future, revoke that election. However, an issuer may continue to request that shareholder to accept electronic delivery or the notice and access model or seek that shareholder's affirmative consent to electronic delivery. Nothing in the proxy rules prohibits an issuer from structuring incentives to encourage shareholders to accept electronic delivery or the notice and access model.

<sup>87</sup> See Rule 14a-16(e) [17 CFR 240.14a-16(e)]. Issuers typically include the meeting notices required by state law at the beginning of their proxy statements. As discussed previously, the new rules would permit any information necessary to meet a state law requirement to accompany or be combined with the Notice.

does not provide an issuer with an option to satisfy its state law obligations by posting those materials on an Internet Web site.

#### **6. Additional Soliciting Materials**

New Rule 14a-16 and revised Rules 14c-2 and 14c-3 require an issuer to post any additional soliciting materials required to be filed under Rule 14a-6(b) on the same Internet Web site on which the proxy materials are posted no later than the day on which the additional soliciting materials are first sent to shareholders or made public.<sup>88</sup> Beyond the posting of the additional soliciting materials on the Internet Web site, issuers may decide which additional means, if any, are most effective for disseminating these materials (e.g., direct mail, e-mail, newspaper publication, etc.).

#### **7. Requests for Copies of Proxy Materials**

An issuer that satisfies its requirement to furnish proxy materials through the notice and access model has a separate requirement under Rule 14a-16(j)<sup>89</sup> to deliver a copy of the proxy statement, annual report to security holders (if applicable) and proxy card to a requesting shareholder. Upon receipt of a request from a shareholder for a copy of the proxy statement, annual report, or proxy card, the issuer must send a copy (in paper or by e-mail, as requested) of those proxy materials to the shareholder within three business days after receiving the request, even if the request is made after the date of the shareholder meeting or corporate action to which the proxy materials relate. However, under the final rules, an issuer would be obligated to provide copies of the proxy

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<sup>88</sup> Exchange Act Rule 14a-6(b) requires an issuer or other soliciting person choosing to deliver additional soliciting materials to file them with the Commission, in the same form that they are sent to shareholders, no later than the date that they are first sent or given to shareholders.

<sup>89</sup> 17 CFR 240.14a-16(j).

materials only up until one year after the conclusion of the meeting or corporate action to which the materials relate. When the issuer provides a paper copy of the proxy materials in response to a shareholder request, the issuer must use first class mail or other reasonably prompt means of delivery.

A few commenters believed that a requirement to send copies of the proxy statement after the shareholder meeting has been held would be an unnecessary burden.<sup>90</sup> However, the proxy statement contains a portion of the total package of annual disclosure for public companies; in fact, many public companies satisfy their obligation to include information in Part III of the Form 10-K by including the information in their proxy statements and incorporating that information by reference into the Form 10-K.<sup>91</sup> Just as the proxy rules require issuers to undertake in their proxy statements or annual reports to shareholders to provide copies of annual reports on Form 10-K for the most recent fiscal year to requesting shareholders,<sup>92</sup> we believe it is appropriate to require issuers to provide copies of the proxy materials to requesting shareholders even after the shareholder meeting date. However, because the proxy statement (like the Form 10-K) is filed on EDGAR, we believe there should be a limit on the length of the period during which a shareholder may request a copy of the proxy materials from the issuer. Therefore, the final rules require issuers to provide the proxy statement and annual report to security holders only for one year after the conclusion of the meeting to which those materials relate.<sup>93</sup>

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<sup>90</sup> See letters from BRT and SCSGP.

<sup>91</sup> See Instruction G(3) to Form 10-K, referenced in 17 CFR 249.310.

<sup>92</sup> See Rule 14a-3(b)(10) [17 CFR 240.14a-3(b)(10)].

<sup>93</sup> See Rule 14a-16(j)(3) [17 CFR 240.14a-16(j)(3)].

We agree with the views of commenters that the proposed two-business day timeframe may be too short for issuers to respond efficiently to paper requests of the proxy materials.<sup>94</sup> Further, it is likely that a longer response period that enables an issuer to better cumulate batches of copies would reduce the cost of complying with the rules. However, these concerns must be balanced against our view that requests for copies be handled promptly. Thus, we have extended the response time to three business days.<sup>95</sup>

The requirements that an issuer deliver the Notice at least 40 calendar days before the shareholder meeting date and respond to a request for a copy of the proxy materials within three business days are designed to provide a shareholder with sufficient time to request a copy, receive it, review the proxy materials and make an informed voting decision. Several commenters believed that placing a deadline on shareholders to request copies would be appropriate.<sup>96</sup> We do not believe such a deadline would be appropriate, particularly because the proxy statement is part of the “package” of disclosures we have deemed important for investors, as discussed above. However, under the rules, it is incumbent on the shareholder to request a copy in sufficient time to receive the copy of the proxy materials, review that copy, and execute a proxy. The rules require the issuer to insert a date in the Notice by which a shareholder should request a copy to ensure timely delivery.<sup>97</sup>

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<sup>94</sup> See, for example, letters from BRT, Computershare, ICI, NY State Bar, SCSGP, SIA, and Sullivan & Cromwell.

<sup>95</sup> See letters from Computershare, ICI, and STA.

<sup>96</sup> See letters from Computershare, SCSGP, and Sullivan & Cromwell.

<sup>97</sup> See Rule 14a-16(d)(1) [17 CFR 240.14a-16(d)(1)]. This date is intended to be a recommendation to shareholders to facilitate timely delivery, but does not restrict a shareholder’s ability to request copies after that date.

Finally, we recognize that some issuers may be hesitant to adopt the notice and access model because of the potential dangers of significantly underestimating, or overestimating, the number of paper copies of the proxy materials that will be needed. If an issuer underestimates that number, the cost of printing additional copies may be great. Similarly, overestimating that number would lead to unnecessary cost. We note that there is nothing in the rules that would prevent an issuer from sending a shareholder a communication well in advance of a proxy solicitation to determine the shareholder's interest in receiving paper copies.<sup>98</sup> Indeed, such a communication may be used to start creating a list of shareholders that wish to receive paper copies in the future. This may help issuers to estimate the number of paper copies that it needs to print for the solicitation.

## **B. The Role of Intermediaries**

### **1. Background**

The process of distributing proxy materials to beneficial owners is considerably more complicated than direct delivery of the materials by an issuer to its record holders.<sup>99</sup> The proxy rules include four rules, Exchange Act Rule 14a-13, Rule 14b-1, Rule 14b-2, and Rule 14c-7 referred to collectively as the "shareholder communications rules," that impose obligations on issuers and intermediaries to ensure that beneficial owners receive proxy materials and are given the opportunity to participate in the shareholder voting

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<sup>98</sup> A communication to shareholders that is limited to explaining the notice and access model generally and determining whether shareholders wish to receive future proxy materials in paper or by e-mail would not be associated with a particular solicitation and therefore would not be considered a Notice under the new rules.

<sup>99</sup> The discussion in this section of "beneficial owners" refers to beneficial owners whose names and addresses do not appear directly in issuers' stock registers because they hold their securities through a broker, bank, trustee, or similar intermediary.

process. Basically, these rules require issuers to send their proxy materials to intermediaries for forwarding to the beneficial owners.

Exchange Act Rule 14b-1 sets forth the obligations of registered brokers and dealers in connection with the prompt forwarding of certain issuer communications to beneficial owners. Rule 14b-2 sets forth similar obligations of banks, associations, and other entities that exercise fiduciary powers. Under these rules, upon request by the issuer, these intermediaries are required to indicate to the issuer within seven business days of receiving the request:

- the approximate number of customers of the intermediary that are beneficial owners of the issuer that are held of record by the intermediary;
- if the issuer has indicated pursuant to Rule 14a-13(a)<sup>100</sup> or 14c-7(a)<sup>101</sup> that it will distribute the annual report to security holders to beneficial owners who have not objected to disclosure to the issuer of their names, addresses, and securities positions, the number of beneficial owners who have objected to such disclosure;<sup>102</sup> and
- the identity of any agents of the intermediary acting on the intermediary's behalf to fulfill its obligations under the rule.

Pursuant to Rules 14b-1 and 14b-2, within five business days of receiving proxy materials from the issuer, the intermediary must forward the materials to beneficial

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<sup>100</sup> 17 CFR 240.14a-13(a).

<sup>101</sup> 17 CFR 240.14c-7(a).

<sup>102</sup> In the case of bank intermediaries, Rule 14b-2 requires a bank to disclose the number of customers with accounts opened on or before December 28, 1986, who gave affirmative consent to disclosure to the issuer and the number of customers with accounts opened after December 28, 1986, who did not object to such disclosure.

owners who will not receive those materials directly from the issuer pursuant to Rule 14a-13(c)<sup>103</sup> or Rule 14c-7(c).<sup>104</sup> Beneficial owners typically do not execute proxy cards because, under most state laws, only the record owner (i.e., the intermediary) has the authority to vote on matters presented to shareholders. As a result, intermediaries forward the proxy materials, other than the proxy card, along with a request for voting instructions. The request for voting instructions is similar to the proxy card, but is prepared by the intermediary instead of the issuer and the beneficial owner returns his or her voting instructions to the intermediary rather than to the issuer or independent vote tabulator. The intermediary is required to vote the beneficial owner's shares in accordance with the owner's voting instructions when formally executing the proxy card.<sup>105</sup> The intermediary then returns the proxy card to the issuer or its vote tabulator.

## **2. Discussion of the Amendments**

Under the amendments, an intermediary may follow the notice and access model only if the issuer requests it to do so and, in such cases, must follow that model. The amendments revise Rules 14b-1 and 14b-2 to require brokers, banks, and similar intermediaries, at the request of an issuer, to furnish proxy materials, including a Notice of Internet Availability of Proxy Materials, to beneficial owners of the issuer's securities based on the notice and access model.<sup>106</sup> If an issuer does not request intermediaries to follow the notice and access model, an intermediary could, on its own initiative, continue to rely on any other permitted method of furnishing proxy materials to beneficial owners,

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<sup>103</sup> 17 CFR 240.14a-13(c).

<sup>104</sup> 17 CFR 240.14c-7(c).

<sup>105</sup> See Rule 14b-2(b)(3) [17 CFR 240.14b-2(b)(3)].

<sup>106</sup> See Rules 14b-1(d) and 14b-2(d) [17 CFR 240.14b-1(d) and 240.14b-2(d)].

including the electronic delivery of proxy materials by affirmative consents, but could not follow the notice and access model on its own initiative. Comments varied on whether an intermediary should be allowed to follow the notice and access model on its own initiative.<sup>107</sup> We believe that the issuer should be allowed to determine the best means for distributing its proxy materials, because the issuer ultimately pays the costs of that distribution.

With respect to beneficial owners, an issuer or other soliciting person relying on the notice and access model must provide the intermediary with all information necessary for the intermediary to prepare its own Notice of Internet Availability of Proxy Materials in sufficient time for the intermediary to prepare and send its Notice to beneficial owners at least 40 days before the meeting date.<sup>108</sup> We understand that issuers, intermediaries and their agents currently coordinate a similar exchange of information to enable intermediaries to prepare and print requests for voting instructions ahead of their receipt of the proxy statement and annual report to security holders for forwarding to beneficial owners.<sup>109</sup> We expect such coordination to continue to facilitate timely preparation of the intermediary's Notice. Therefore, we have not included a specific timeframe in the rules for delivery of this information.<sup>110</sup> Upon receipt of that information, the intermediary or its agent must prepare its own Notice, tailored for the intermediary's beneficial owner

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<sup>107</sup> See, for example, letters from ABA, ACC, Computershare, and SCSGP, supporting issuer control, as opposed to the letters from SIA, Swingvote, and University Bancorp, urging more control by intermediaries.

<sup>108</sup> See Rule 14a-16(a)(2) [17 CFR 240.14a-16(a)(2)].

<sup>109</sup> Our rules set forth a series of timeframes regarding distribution of proxy materials to beneficial owners to facilitate timely delivery of those materials.

<sup>110</sup> Rule 14a-16(a)(2) requires an issuer to provide the information to an intermediary "in sufficient time" for the intermediary to prepare its own Notice. Other soliciting persons

customers.<sup>111</sup> The intermediary must send this Notice to beneficial owners at least 40 calendar days before the date of the shareholder meeting.<sup>112</sup>

The intermediary's Notice will generally contain the same information as an issuer's Notice,<sup>113</sup> with certain revisions to reflect the differences between registered holders and beneficial owners. Specifically, the intermediary's Notice must contain the following information:

- A prominent legend in bold-face type that states:  
  
**"Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date]."**<sup>114</sup>
- **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.**
- **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**
- **If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as**

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would be expected to provide their information to intermediaries in sufficient time to meet their applicable deadlines.

<sup>111</sup> An intermediary's Notice prepared in accordance with this rule would be impartial for purposes of Rule 14a-2(a)(1) [17 CFR 240.14a-2(a)(1)] and need not be filed pursuant to Rule 14a-6(b) [17 CFR 240.14a-6(b)] unless an intermediary solicits proxies on its own behalf.

<sup>112</sup> In the case of a Notice of a soliciting person other than the issuer, the intermediary must send the Notice to beneficial owners by the later of: (1) 40 calendar days prior to the meeting; or (2) 10 calendar days after the issuer first sends its proxy materials to investors. See Section II.C of this release.

<sup>113</sup> See Rule 14a-16(d) [17 CFR 240.14a-16(d)].

<sup>114</sup> Appropriate changes must be made to the Notice if the issuer is providing an information statement pursuant to Regulation 14C or if the issuer or other soliciting person is seeking to effect a corporate action by written consent.

**instructed below on or before [Insert a date] to facilitate timely delivery."**

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on and the issuer's or other soliciting person's recommendations regarding those matters, but no supporting statements; and
- A list of the materials being made available at the specified Web site.

The intermediary may choose whether to direct beneficial owners to the issuer's Web site or to its own Web site to access the proxy disclosure materials. If it directs beneficial owners to its own Web site, access to that website must be free of charge and may not compromise a beneficial owners' anonymity. If it directs beneficial owners to the issuer's Web site, the intermediary must inform beneficial owners that they can submit voting instructions to the intermediary, but cannot execute a proxy directly in favor of the issuer unless the intermediary has executed a proxy in favor of the beneficial owner. In addition, the intermediary must provide the following information in its Notice, which is similar to the information in the issuer's Notice, but applicable only to beneficial owners:

- (1) A toll-free telephone number of the intermediary or its agent, (2) an e-mail address of the intermediary or its agent, and (3) an Internet Web site of the intermediary or its agent where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the Notice relates;

- Any control/identification numbers that the beneficial owner needs to access his or her request for voting instructions;
- Instructions on how to access the request for voting instructions on the Web site of the intermediary or its agent, provided that such instructions do not enable a beneficial owner to provide voting instructions without having access to the proxy statement and annual report;
- Information on how to obtain directions to be able attend the meeting and vote in person;<sup>115</sup> and
- A brief description, if applicable, of the rules that permit the intermediary to vote the securities if the beneficial owner does not return his or her voting instructions.<sup>116</sup>

The intermediary's Notice must contain instructions on how to access the request for voting instructions on the Web site of the intermediary or its agent. Such information should include any control or identification numbers necessary for the beneficial owner to provide voting instructions. However, the intermediary's Notice cannot include a means, such as a telephone number, which would enable the beneficial owner to provide voting instructions without having access to the proxy statement and annual report. A telephone number that a beneficial owner can use to provide voting instructions may be provided on the Internet Web site on which the request for voting instructions is posted (as well as on a paper request for voting instructions sent to shareholders 10 days or more after the intermediary's Notice was sent). Like an issuer, the intermediary cannot include a

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<sup>115</sup> A beneficial owner wishing to attend the meeting and vote in person must obtain proxy voting authority from the intermediary through which he or she owns the security.

<sup>116</sup> See NYSE Rule 452.

request for voting instructions with its Notice. However, at the issuer's request, the intermediary will be required to send a copy of the request for voting instructions to beneficial owners, provided that 10 days have passed since the intermediary's Notice was first sent. A copy of the intermediary's Notice, or a copy of the proxy statement, must accompany that request for voting instructions.

### **3. Request for Copies by Beneficial Owners**

The intermediary's Notice must provide instructions on how a beneficial owner can request a copy of the proxy materials from the intermediary, rather than from the issuer. Under the new rules, a beneficial owner may not request a paper or e-mail copy directly from the issuer as originally proposed. We are making this revision to the proposal for several reasons. First, an issuer has no means to track the identity and preferences of beneficial owners for future solicitations because these owners are not registered in an issuer's records as shareholders of the company. This tracking can be performed most efficiently by the intermediary because only it maintains records of the beneficial owner's security holdings. Second, the intermediary is able to apply a beneficial owner's request for paper or e-mail copies across all of a beneficial owner's security holdings on an account-wide basis, making it easier for beneficial owners to elect to receive such copies with respect to all of the securities held by the beneficial owner.

If a beneficial owner requests a copy of the materials from the intermediary, the intermediary must in turn request such a copy from the issuer or other soliciting person within three business days of receiving the request from the beneficial owner. The intermediary also would have to forward the materials to the beneficial owners within

three business days after receipt from the issuer or other soliciting person.<sup>117</sup> As originally proposed, the intermediary will be allowed to charge the issuer or other soliciting person for the cost it incurs in forwarding the copy of the proxy materials to the requesting beneficial owner.<sup>118</sup>

We also note that intermediaries typically keep records of whether a beneficial owner has affirmatively consented to electronic delivery of proxy materials on an account-wide basis. That is, a beneficial owner's election for electronic delivery applies to all securities in the beneficial owner's account, rather than to specific issuers. To make it clear to beneficial owners electing to receive copies of the proxy materials on an ongoing basis, the intermediary's Notice must clarify that a permanent election to receive copies of the proxy materials in paper or e-mail will apply to all securities in the beneficial owner's account.<sup>119</sup>

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<sup>117</sup> Thus, the intermediary must request the copy from the issuer within three business days of receiving the shareholder's request. Then the issuer must send the copy to the intermediary, which is a record holder or respondent bank under the final rules, within three business days of receiving the intermediary's request. Finally, the intermediary is required to forward the copy to the requesting shareholder within three business days of receiving the copy from the issuer.

<sup>118</sup> See NYSE Rule 465. We note that a Proxy Working Group established by the NYSE is reviewing the NYSE's current schedule of the specific maximum fees that NYSE member firms can charge an issuer under our rules requiring issuers to reimburse intermediaries for their reasonable direct and indirect expenses for forwarding proxy materials. We intend to work closely with the NYSE to evaluate the types of revisions that may be appropriate in light of our adoption of the notice and access model, including revision of existing fees as well as the creation of any new fees that may be reasonable under the notice and access model. Although NYSE Rule 465 applies only to NYSE member firms, other national securities exchanges have a similar rule and fee schedule. Non-broker intermediaries, such as banks, also rely on the fee schedule as an industry standard.

<sup>119</sup> See Rules 14b-1(d)(4)(iii) and 14b-2(d)(4)(iii) [17 CFR 240.14b-1(d)(4)(iii) and 240.14b-2(d)(4)(iii)].

One commenter was concerned that the notice and access model only complicates an already complicated process for transmitting proxy materials to beneficial owners and may confuse shareholders.<sup>120</sup> Other commenters recommended that the Commission review the proxy delivery process as a whole, rather than layer this model over the existing distribution regime.<sup>121</sup> Although the Commission is sensitive to these concerns, a complete review of the proxy system at this time would only delay the potential benefits to issuers and shareholders offered by the notice and access model. As we gain additional experience with these rules, we will consider whether more extensive revisions to the proxy rules are warranted.

In summary, the amendments would impose the following responsibilities on intermediaries that are requested by an issuer to follow the notice and access model:

- The intermediary must prepare its own Notice and deliver this Notice to its beneficial owners after receiving the meeting information from the issuer or other soliciting person;
- The intermediary must send its Notice to beneficial owners at least 40 days prior to the meeting;
- The intermediary must post its request for voting instructions on an Internet Web site;
- The intermediary must maintain records of beneficial owners who make a permanent election to receive paper or e-mail copies of the proxy materials for all securities held in the beneficial owner's account; and

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<sup>120</sup> See letter from ABA.

<sup>121</sup> See, for example, letters from BRT, Concerned Shareholders, Computershare, Carl Hagberg, Mellon, and STA.

- The intermediary must request a copy of the proxy materials from the issuer or other soliciting person within three business days after receiving a request from its beneficial owner customer and must forward that copy to the beneficial owner customer within three business days after receiving the copy from the issuer or other soliciting person.

### **C. Soliciting Persons Other Than the Issuer**

Under the amendments, a person other than the issuer who undertakes his or her own proxy solicitation also can rely on the notice and access model. This situation typically would occur in the context of a proxy contest between a shareholder and management. We anticipate that the notice and access model will provide an alternative that may decrease significantly the printing and mailing costs associated with a proxy solicitation. We also believe that the same arguments that support modifying the existing framework to facilitate an alternative dissemination option for issuers apply equally to soliciting persons other than issuers.

Several commenters supported extending the notice and access model to such parties.<sup>122</sup> However, some commenters were concerned about the possibility of abuse of the model by shareholders conducting nuisance contests.<sup>123</sup> These commenters recommended that the availability of the model be limited for soliciting persons other than the issuer.<sup>124</sup> The proposed limitations included requiring the solicitation of all shareholders,<sup>125</sup> requiring soliciting persons other than the issuer to provide copies of

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<sup>122</sup> See, for example, letters from CALSTRS, Computershare, and Swingvote.

<sup>123</sup> See, for example, letters from Glen Buchbaum.

<sup>124</sup> See, for example, letters from ABA, ACC, BRT, ICI, ISS, Sullivan & Cromwell, and Swingvote.

<sup>125</sup> See letters from BRT and Swingvote.

their proxy materials upon request,<sup>126</sup> and imposing a minimum shareholding requirement in order for a soliciting person to take advantage of the model.<sup>127</sup> Although the amendments would reduce the cost of a proxy contest, they do not eliminate all costs, such as costs of preparing the soliciting materials, legal fees, proxy solicitor fees, and other significant soliciting expenses. We believe these surviving costs should discourage frivolous contests.

Although the mechanics of a solicitation under the notice and access model for a person other than the issuer are similar to those incurred by an issuer, we describe below several important differences in the way the amendments affect soliciting persons other than the issuer.

#### **1. Mechanics of Proxy Solicitations by Persons Other Than the Issuer**

The proxy rules currently treat persons other than the issuer differently from the issuer in a significant respect regarding the provision of information to shareholders regarding intended corporate actions. Specifically, an issuer must furnish to each shareholder either a proxy statement, if the issuer is soliciting proxies or consents from shareholders, or an information statement pursuant to Section 14(c) of the Exchange Act<sup>128</sup> regarding shareholder meetings where corporate action is to be taken but no proxy authority or consent is sought.

Soliciting persons other than the issuer are not subject to the requirements of Section 14(c). Thus, unlike the issuer, they have no obligation to furnish an information statement to shareholders from whom no proxy authority is sought. As a result, soliciting

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<sup>126</sup> See letter from ABA.

<sup>127</sup> See letters from ABA, ICI and Sullivan & Cromwell.

<sup>128</sup> 15 U.S.C. 78n(c).

persons can limit the cost of a solicitation by soliciting proxies only from a select group of shareholders, such as those with large holdings, without furnishing other shareholders with any information. This enables a person other than the issuer to conduct a proxy contest in a variety of ways, some of which are not available to an issuer. The amendments that we are adopting relate only to the means of furnishing information to shareholders, and thus do not affect a soliciting person's ability to effect such targeted solicitations.

Under the new rules, a soliciting person other than the issuer may follow the same procedures as the issuer.<sup>129</sup> In particular, it may furnish a Notice and post the proxy statement on an Internet Web site. As with an issuer, such a soliciting person may not include a proxy card with the Notice. It may, however, send a proxy card to the shareholders it is soliciting without a proxy statement 10 calendar days or more after initially sending the Notice to them, if the proxy card is accompanied either by a copy of the proxy statement or by another copy of the Notice.

A soliciting person other than the issuer may selectively solicit shareholders under the notice and access model, just as it could under the current proxy rules (e.g., the soliciting person could choose to send the Notice only to certain shareholders, such as those owning more than a specified number of shares). As we discuss in more detail below, we have made revisions to Rule 14a-7 that will enable a soliciting person to distinguish between shareholders who have requested paper copies of the proxy materials

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As with the case of an issuer, the soliciting person also may solicit shareholders concurrently by any other means, for example, by sending a proxy statement and proxy card to certain shareholders.

and those who have not.<sup>130</sup> Under the notice and access model, a soliciting person other than the issuer may choose to send a Notice only to those shareholders who have not requested paper copies of the proxy materials.

In the proposing release, we proposed a provision that would have permitted a soliciting person other than the issuer to send a Notice that would condition the solicitation on a shareholder's willingness to access the proxy materials on an Internet Web site. One commenter suggested that a soliciting person should not be permitted to condition its solicitation in this manner and should have to provide a copy of its proxy statement to a requesting shareholder.<sup>131</sup> We are persuaded that a shareholder receiving a Notice reasonably may conclude that he or she is entitled to receive a copy of the materials. Therefore, the final rules require a soliciting person other than an issuer to send a paper or e-mail copy of the proxy statement to any requesting shareholder to whom it has sent a Notice.<sup>132</sup>

## **2. Timeframe for Sending Notice of Internet Availability of Proxy Materials**

A solicitation in opposition to the issuer's proposals to be voted on at a shareholder meeting often is not initiated until after the issuer has filed its proxy statement. As we noted in the proposing release, we therefore believe that it may be unfair to apply the same timeframe for distributing the Notice to soliciting persons as the

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<sup>130</sup> 17 CFR 240.14a-7.

<sup>131</sup> See letter from ABA.

<sup>132</sup> The proposing release also discussed the possibility of an electronic-only solicitation in which the soliciting person publishes a communication pursuant to Rule 14a-12 [17 CFR 240.14a-12], but does not send any Notices to shareholders. We are not adopting the electronic-only option that we discussed in the proposing release as part of the notice and access model. However, as noted in the final rules, the amendments do not affect the

timeframe that applies to issuers. Therefore, the amendments require a soliciting person other than the issuer that is following the notice and access model to send out its Notice by the later of: (1) 40 calendar days prior to the meeting; or (2) 10 calendar days after the issuer first sends out its proxy statement or Notice to shareholders. This is substantially the same requirement we proposed, except that we have changed the proposed 30-day deadline to 40 days to conform it to our revision of the deadline for issuers.

**3. Content of the Notice of Internet Availability of Proxy Materials of a Soliciting Person Other Than the Issuer**

The content of the Notice sent by a soliciting person other than the issuer could be different from the content of the issuer's Notice. For example, if a solicitation in opposition is launched before the issuer has sent its own proxy statement or Notice, the full shareholder meeting agenda may not be known to the soliciting person at the time it sends its Notice to shareholders. In such a case, the soliciting person must include the agenda items in its Notice only to the extent known.<sup>133</sup>

Also, there may be circumstances in which a person soliciting proxies in opposition to the issuer may provide a partial proxy card, that is, a proxy card soliciting proxy authority only for the agenda items in which the soliciting person is interested rather than for all of the items, or presenting only a partial slate of directors. Typically, such a proxy would revoke any previously-executed proxy and the shareholder may lose his or her ability to vote on matters or directors other than those presented on the soliciting person's card. To prevent a shareholder from unknowingly invalidating his or

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availability of any existing means by which an issuer or other person may furnish proxy materials under the proxy rules.

<sup>133</sup> See Rule 14a-16(l)(3)(i) [17 CFR 240.14a-16(l)(3)(i)].

her vote on those other matters, a person soliciting in opposition that is presenting such a card to shareholders must indicate clearly on its Notice whether execution of that card will invalidate the shareholder's earlier vote on the other matters or directors reflected on the issuer's proxy card.

#### **4. Shareholder Lists and the Furnishing of Proxy Materials by the Issuer**

Exchange Act Rule 14a-7 sets forth the obligation of issuers either to provide a shareholder list to a requesting shareholder or to send the shareholder's proxy materials on the shareholder's behalf. That rule provides that the issuer has the option to provide the list or send the shareholder's materials, except when the issuer is soliciting proxies in connection with a going-private transaction or a roll-up transaction.<sup>134</sup> Under the amendments, if the issuer is providing its shareholder list to a soliciting person, the issuer would be required to indicate which of those shareholders have permanently requested paper copies of proxy materials.<sup>135</sup> The proposed rules would have required an issuer to share all information about its shareholders regarding electronic delivery. We have decided to limit this requirement.

One commenter was concerned that a requirement to share information on affirmative consents may violate the issuer's privacy policies and the terms of the consent agreement between the issuer and shareholder.<sup>136</sup> The commenter also was concerned about divulging employees' internal company e-mail addresses. We agree with this

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<sup>134</sup> See Exchange Act Rule 14a-7(b) [17 CFR 240.14a-7(b)]. If the issuer is soliciting proxies in connection with a going-private transaction or a roll-up transaction, the shareholder has the option to request the shareholder list or have the issuer send its materials.

<sup>135</sup> See proposed Note 3 to Exchange Act Rule 14a-7.

<sup>136</sup> See letter from SCSGP.

comment and are not adopting that aspect of the proposal. However, the new rules do require an issuer to share information regarding whether a shareholder has made a permanent election to receive paper copies of the proxy materials. Such disclosure would not necessitate disclosure of a shareholder's e-mail address. In addition, a shareholder who has made a permanent election to receive paper copies of the issuer's proxy materials might reasonably expect to receive paper copies of proxy materials from other soliciting persons. Once that shareholder has made a permanent election, he or she should not be required to ask again for a paper copy of proxy materials.<sup>137</sup>

Similarly, if, under Rule 14a-7, the issuer elects to send the soliciting person's proxy materials, the amendments require the issuer to refrain from forwarding the other soliciting person's Notice to any shareholder who has made a permanent election to receive paper copies.<sup>138</sup> If the soliciting person requests that the issuer follow the notice and access model, the soliciting person would be responsible for providing the issuer with copies of its Notice for all shareholders to whom it intends to provide a Notice. In that case, the issuer would have to send the soliciting person's Notice with reasonable promptness after receipt from the soliciting person. An issuer could not decide on its own whether to send a soliciting person's materials in paper or electronically. If the other soliciting person wishes to send a proxy card to shareholders 10 or more days after it first

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<sup>137</sup> As noted above, this election would be effective until a shareholder revokes that election.

<sup>138</sup> The other soliciting person could, of course, provide paper copies of the proxy statement and proxy card to the issuer for forwarding to those shareholders who have elected to receive paper copies.

sends the Notice, the issuer would be required to forward those proxy cards in a similar fashion.<sup>139</sup>

## **5. The Role of Intermediaries With Respect to Solicitations by Persons Other Than the Issuer**

Intermediaries generally furnish proxy materials to beneficial owners on behalf of soliciting persons other than the issuer under the conditions set forth in Exchange Act Rules 14b-1 and 14b-2.<sup>140</sup> Although intermediaries historically have transmitted a soliciting person's proxy materials in reliance on the procedures set forth in Rules 14b-1 and 14b-2, these two rules do not explicitly address an intermediary's obligations with respect to the forwarding of a soliciting person's proxy materials. As proposed, the amendments clarify that intermediaries are obligated to send proxy materials on behalf of soliciting persons other than the issuer.

### **D. Business Combination Transactions**

As adopted, the notice and access model is not available with regard to proxy materials related to a business combination transaction, which includes transactions covered by Rule 165 under the Securities Act,<sup>141</sup> as well as transactions for cash consideration requiring disclosure under Item 14 of Schedule 14A. Several commenters<sup>142</sup> agreed that business combination transactions constitute highly extraordinary events for some issuers and frequently involve an offering of securities that

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<sup>139</sup> As noted above, the issuer may alternatively provide the other soliciting person with a list of shareholders pursuant to Rule 14a-7.

<sup>140</sup> See Randall S. Thomas & Catherine T. Dixon, *Aranow & Einhorn on Proxy Contests for Corporate Control*, at §8.03(C) (3d ed. 2001).

<sup>141</sup> 17 CFR 230.165. This prohibition would extend to persons who solicit proxies that are not parties to the transaction and any proxy materials in opposition to the transaction.

<sup>142</sup> See, for example, letters from ABA, Hermes, and Sullivan & Cromwell.

must be registered under the Securities Act and require delivery of the prospectus.<sup>143</sup> They also typically involve proxy statements of considerable length and complexity. Other commenters nonetheless believed that the model should be extended to such transactions.<sup>144</sup> They noted that even more savings may be realized by extending the model to such larger documents. The Commission desires to gain more experience with the notice and access model before extending it to business combination transactions. Based on our experience with the model once it is being used for more straightforward corporate actions, we will consider at a later date whether it is appropriate to extend the model to business combination transactions.

#### **E. Compliance Date and Monitoring**

No issuer may send a Notice to shareholders before July 1, 2007. Issuers and intermediaries typically hire third parties to handle the logistics of proxy distribution. These companies will require time to adjust their systems to accommodate the notice and access model. Therefore, an issuer may not use the new model for meetings before August 10, 2007 because of the 40-day deadline. Similarly, if an issuer's meeting will be on or after August 10, 2007, it may only send the Notice on or after July 1, 2007, even if the issuer wishes to send the Notice more than 40 days prior to the meeting date.

We desire to track the industry's experience with the notice and access model to determine whether the rules are achieving their intended purposes. However, we do not currently intend to impose a requirement for issuers and other parties to provide us with

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<sup>143</sup> The prospectus delivery requirements applicable to business combination transactions were not impacted by our securities offering reform initiative because such transactions were excluded. See Release No. 33-8591 (July 19, 2005) [70 FR 44271].

<sup>144</sup> See, for example, letters from BRT, CALSTRS, Computershare, ICI, ISS, McData Corp, NY State Bar, Swingvote, SCSGP, William Sjostrom, and University Bancorp.

data and experiences with the model. We welcome information from issuers and all other parties involved in the proxy distribution process about their experience with the notice and access model on a voluntary basis. Such information would include itemized costs of proxy solicitation before and after adoption of the model, shareholder voting data before and after adoption, the number of copies requested, and any problems encountered with implementing the program. Although such information may be aggregated with the data and experiences of others and presented to the public, we do not intend to divulge the identity of responding parties.

#### **IV. Conforming and Correcting Revisions to the Proxy Rules**

The adopted rules reflect numerous amendments to terms used in the current proxy rules to explicitly accommodate the notice and access model. The changes are as follows:

- We substitute the term “send” and other tenses of the verb for the term “mail” and its other tenses to avoid any misunderstanding that “mail” means only paper delivery through the U.S. mail system.<sup>145</sup>
- We clarify that the term “address” includes an electronic mail address.<sup>146</sup>

Furthermore, we clarify the use of the term “annual report(s)” in the proxy rules by changing all references to either “annual report(s) to security holders” or “annual report(s) on Form 10-K and/or Form 10-KSB,” as appropriate.<sup>147</sup> Finally, we are

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<sup>145</sup> Rules 14a-4(c)(1), 14a-8(e)(2), 14a-8(e)(3), 14a-8(m)(3), 14a-13(a)(5), 14a-13(c), 14b-1(c)(2)(ii), 14b-2(c)(2)(ii), 14c-5(a) and 14c-7(a)(5). Also Note 2 to Rule 14a-13(a), Instruction 2 to paragraph (d)(2)(ii)(L) of Item 7 of Rule 14a-101, Note 2 to Rule 14c-7(a) and Instruction 1 to Item 4 of Rule 14c-101.

<sup>146</sup> Rules 14a-7(f), 14a-13(e), 14b-1(a)(2) and 14b-2(a)(4).

<sup>147</sup> Rules 14a-3(b)(1), 14a-3(b)(10), 14a-3(b)(13), 14a-3(e)(1)(i), 14a-3(e)(1)(i)(A), 14a-3(e)(1)(i)(B), 14a-3(e)(1)(i)(C), 14a-3(e)(1)(i)(E), 14a-3(e)(1)(ii)(A),

updating Rule 14a-2 and Forms 10-Q, 10-QSB, 10-K, 10-KSB, and N-SAR to revise outdated references to Exchange Act Rule 14a-11, which the Commission rescinded in 1999.<sup>148</sup>

## **V. Paperwork Reduction Act**

### **A. Background**

The amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).<sup>149</sup> We published a notice requesting comment on the collection of information requirements in the proposing release, and submitted requests to the Office of Management and Budget for approval in accordance with the PRA.<sup>150</sup> These requests were approved by OMB. Some of the revisions that we are making to the original proposal affect these collections of information. We will submit requests for approval of the revisions to OMB. We are requesting comment in this release with respect to these revisions.

The titles for the collections of information are:<sup>151</sup>

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14a-3(e)(1)(ii)(B)(2), 14a-3(e)(1)(ii)(B)(2)(ii), 14a-3(e)(1)(ii)(B)(2)(iii), 14a-3(e)(1)(ii)(B)(3), 14a-3(e)(1)(iii), 14a-3(e)(2), 14a-3(e)(2)(i), 14a-3(e)(2)(ii), 14a-12(c)(1), 14b-1(b)(2), 14b-1(c)(2)(ii), 14b-1(c)(3), 14b-2(b)(3), 14b-2(c)(2)(ii), 14b-2(c)(4), 14c-2(a)(2), 14c-3(a)(1) and 14c-3(c). Also Note to paragraph (e)(1)(i)(B) of Rule 14a-3, Note D(3) to Rule 14a-101, Note G(1) to Rule 14a-101, Instruction 1 to paragraph (d)(2)(ii)(L) of Item 7 of Rule 14a-101, paragraph (e)(2) of Item 14 of Rule 14a-101, Item 23 of Rule 14a-101, paragraph (a), (b), (c) and (d) of Item 23 to Rule 14a-101, Note 1 to paragraph (b)(2) of Rule 14b-1, Note 1 to paragraph (b)(3) of Rule 14b-2, section heading to Rule 14c-3, Item 5 of Rule 14c-101 and paragraph (a), (b), (c) and (d) of Item 5 of Rule 14c-101.

<sup>148</sup> See Release No. 33-7760 (Oct. 22, 1999) [64 FR 61408].

<sup>149</sup> 44 U.S.C. 3501 *et seq.*

<sup>150</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>151</sup> In the proposing release, we described the proposed Notice of Internet Availability of Proxy Materials as a new collection of information, rather than a part of our existing collections of information related to Regulations 14A and 14C. However, we subsequently submitted to OMB a PRA analysis based on revisions to the Regulation

Regulation 14A (OMB Control No. 3235-0059)

Regulation 14C (OMB Control No. 3235-0057)

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.

**B. Summary of Amendments**

The amendments will apply to a particular issuer or other soliciting person only if the issuer or soliciting person voluntarily chooses to rely on the notice and access model. However, if the issuer or soliciting person opts to rely on the new alternative model, compliance with the components of the model is mandatory. The Notices, the proxy materials posted on the Web site, and copies of the proxy materials sent in response to shareholder requests will not be kept confidential.

The Notice must include the following prominent legend in bold-face type and other information described below:

**“Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].”<sup>152</sup>**

- **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.**
- **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**

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14A and Regulation 14C collections. Based on our burden estimates associated with the Notice, the collection of information approved by OMB related to revisions to existing collections of information (Regulations 14A and 14C) and therefore we refer to those collections of information in this PRA discussion.

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Appropriate changes must be made to the Notice if the issuer is providing an information statement pursuant to Regulation 14C or seeking to effect a corporate action by written consent.

- **If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery.”**
- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted upon and the issuer’s or other soliciting person’s recommendations regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- (1) A toll-free telephone number; (2) an e-mail address; and (3) an Internet Web site address where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the Notice relates;
- Any control/identification number that the shareholder needs to access his or her proxy card;
- Instructions on how to access the proxy card, provided that such instructions do not enable a shareholder to execute a proxy without having access to the proxy statement and annual report; and
- Information on how to obtain directions to be able to attend the meeting and vote in person.

Intermediaries must provide a similar notice to beneficial owners. We expect that all of the factual information required to appear in the Notice will become available as part of the ordinary preparations for a shareholder meeting.

### **C. Comments on PRA Estimates**

We requested comment on the PRA analysis contained in the proposing release. In the proposing release, we estimated the annual burden for an issuer or other soliciting person to prepare a Notice to be approximately 1.5 hours. We estimated that 75% of the burden would be prepared by the issuer and that 25% of the burden would be prepared by outside counsel retained by the issuer at an average cost of approximately \$300 per hour.<sup>153</sup> Based on our receipt of 7,301 filings on Schedule 14A and 681 filings on Schedule 14C during our 2005 fiscal year, we estimated that 7,982 Notices would be filed annually, assuming that all issuers and other soliciting persons elected to follow the proposed notice and access model.<sup>154</sup> We further estimated that the total annual reporting burden would be approximately 8,980 hours.<sup>155</sup> Using the revised \$400 average cost for retaining outside counsel, we are adjusting our annual cost estimate to approximately \$1,197,300,<sup>156</sup> which reflects the outside counsel cost.

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<sup>153</sup> For convenience, the estimated PRA hour burdens have been rounded to the nearest whole number, and the estimated PRA cost burdens have been rounded to the nearest \$100. At the proposing stage, we used an estimated hourly rate of \$300.00 to determine the estimated cost to public companies of executive compensation and related disclosure prepared or reviewed by outside counsel. We recently have increased this hourly rate estimate to \$400.00 per hour after consulting with several private law firms. The cost estimates in this release are based on the \$400.00 hourly rate. We request comment on this estimated hourly rate.

<sup>154</sup> 7,301 notices for 14A filers + 681 notices for 14C filers = 7,982 total notices.

<sup>155</sup> 7,982 notices x 1.5 hours per notice x .75 = 8,980 hours.

<sup>156</sup> 7982 notices x \$400/hour x 1.5 hours/notice x .25 = \$1,197,300.

Although the notice and access model is an alternative to the existing model for the distribution of proxy materials to shareholders, and reliance upon it will be optional, we based our reporting burden and cost estimates on the assumption that all issuers or other soliciting persons in fiscal year 2005 would have relied on the notice and access model even though we realized that this would result in an overestimation of hour and cost burdens. The new alternative is voluntary, so the percentage of issuers and soliciting persons that will choose to rely on the new model is uncertain.

In response to commenters' remarks, we revised the proposal to require issuers to permit shareholders to make permanent elections to receive proxy materials in paper or by e-mail. An issuer must maintain records as to which of its shareholders have made such an election. Many issuers already maintain similar records to keep track of their shareholders who have affirmatively consented to electronic delivery consistent with past Commission guidance,<sup>157</sup> as well as their shareholders who have consented to householding of proxy materials pursuant to Rule 14a-3(e).<sup>158</sup> For purposes of the PRA, we estimate that a typical issuer will spend an additional five hours per year, or a total of 39,910 hours for all issuers subject to the proxy rules, to maintain these records.<sup>159</sup> Because this is an internal recordkeeping requirement, we do not expect a cost for hiring outside counsel.

The final rules also require an intermediary to prepare its own Notice. This Notice would be substantially the same as an issuer's Notice, but will be modified by the

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<sup>157</sup> See the 1995 Interpretive Release.

<sup>158</sup> 17 CFR 240.14a-3(e).

<sup>159</sup> 7,982 filings with an estimated one filing per issuer or soliciting person x 5 hours = 39,910 hours.

intermediaries to provide information that is relevant to beneficial owners rather than registered holders. According to ADP, it processes more than 95% of proxy materials that are sent to beneficial owners on behalf of intermediaries, reducing the need to create multiple intermediary Notices. In addition, the issuer or other soliciting person will provide the majority of information required in the intermediary's Notice. Therefore, we estimate that the burden to prepare an intermediary's Notice will be approximately one hour, or a total annual burden of 7,982 hours for all proxy solicitations.<sup>160</sup>

Intermediaries must also maintain records to keep track of which beneficial owners have made a permanent election to receive proxy materials in paper or by e-mail. Like issuers, intermediaries already maintain records of shareholders' affirmative consents to electronic delivery and householding of proxy materials. In addition, intermediaries maintain records as to whether their beneficial owner customers have objected, or not objected, to disclosure of their identities to the issuer. Like issuers, we believe this will result in an annual burden of 39,910 hours for intermediaries.

We did not receive any comments on the percentage of issuers and persons likely to rely on the notice and access model, nor did we receive any comments on our burden and cost estimates associated with preparing the Notice. However, several corporate commenters indicated that some issuers might be reluctant to rely on the notice and access model due to a concern that the costs of fulfillment of requests for paper copies under the model might offset some of the potential savings that they could realize from

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<sup>160</sup> 7,982 notices x 1 hour per notice = 7,982 hours. We do not include a cost to intermediaries for hiring outside counsel because we expect that the substantive contents of an intermediary's Notice would be provided by the issuer or other soliciting person. The estimates assume that ADP will continue to process over 95% of the proxy solicitations on behalf of intermediaries, thereby eliminating the need for each intermediary to prepare a separate Notice.

the model. We have revised the proposed model to address some of these concerns about fulfillment of requests for paper copies, but it is still difficult to predict the number of issuers and soliciting persons that will rely on the model. Therefore, we are not revising the original estimates that assume that all issuers and soliciting persons will rely on the notice and access model. As a result, these burden estimates likely are overstated. We will adjust them after we have actual experience with the notice and access model. We request comment on all of our hourly and cost burden estimates.

Any member of the public may direct to us any comments concerning these burden and cost estimates and any suggestions for reducing the burdens and costs. Persons who desire to submit comments on the collections of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303, with reference to File No. S7-10-05. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-10-05, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

## **VI. Cost-Benefit Analysis**

### **A. Background**

The amendments to the proxy rules enable issuers to take advantage of technological advances that have occurred in recent years to more efficiently furnish proxy materials to shareholders. We expect that these amendments will lead to significant cost reduction for proxy solicitations. The costs of solicitations ultimately are borne by shareholders. We are sensitive to the costs and benefits that result from our rules. In this section, we examine those costs and benefits.

Issuers and other persons soliciting proxies must comply with the rule amendments only if they elect to furnish proxy materials pursuant to the notice and access model. No issuer or person conducting a proxy solicitation will be required to follow the notice and access model. We expect that an issuer or other soliciting person will follow the model only if it believes that it will experience cost savings as a result. We expect that having a choice among alternative models for furnishing proxy materials will limit the costs of the amendments by enabling issuers and other soliciting persons to choose one that is most efficient and cost effective under the issuer's or other soliciting person's particular circumstances.

### **B. Summary of Amendments**

The amendments provide an alternative notice and access model that permits an issuer to furnish its proxy materials to shareholders by posting them on a publicly-accessible Internet Web site (other than the Commission's EDGAR Web site) and providing shareholders with a notice informing them that the materials are available and

explaining how to access them. Under this alternative model, shareholders may request paper or e-mail copies of the proxy materials at no charge from the issuer.

Under the amendments, an issuer can require intermediaries to follow similar procedures when forwarding the issuer's proxy materials to beneficial owners. In addition, shareholders and other persons conducting their own proxy solicitations may follow the alternative model, under the same general requirements that apply to issuers. However, such persons will be able to limit their solicitations to shareholders who have not requested paper copies of the proxy materials from an issuer in connection with the issuer's solicitation.

### **C. Benefits**

The benefits to investors of the amendments include the following: (1) more rapid dissemination of proxy information to shareholders using the Internet; and (2) reduced printing and mailing costs for issuers, as well as other soliciting persons engaging in proxy contests. We expect that the reductions in printing and mailing costs and the potential decrease in the costs of proxy contests to be the most significant sources of economic benefit to investors of the amendments.

In terms of paper processing alone, the benefits of the rule amendments are limited by the volume of paper processing that would occur otherwise. As we noted in the proposing release, Automatic Data Processing, Inc. (ADP) handles the vast majority of proxy mailings to beneficial owners.<sup>161</sup> ADP publishes statistics that provide useful background for evaluating the likely consequences of the rule amendments. ADP

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<sup>161</sup> We expect savings per mailing to record holders to roughly correspond to savings per mailing to beneficial owners.

estimates that, during the 2006 proxy season,<sup>162</sup> over 69.7 million proxy material mailings were eliminated through a variety of means, including householding and existing electronic delivery methods. During that season, ADP mailed 85.3 million paper proxy items to beneficial owners. ADP estimates that the average cost of printing and mailing a paper copy of a set of proxy materials during the 2006 proxy season was \$5.64. We estimate that issuers and other soliciting persons spent, in the aggregate, \$481.2 million in postage and printing fees alone to distribute paper proxy materials to beneficial owners.<sup>163</sup> Approximately 50% of all proxy pieces mailed by ADP in 2005 were mailed during the proxy season.<sup>164</sup> Therefore, we estimate that issuers and other persons soliciting proxies from beneficial owners spent approximately \$962.4 million in 2006 in printing and mailing costs.<sup>165</sup>

Based on the assumption that 19% of shareholders will choose to have paper copies sent to them when an issuer relies on the notice and access model, we estimate that the amendments could produce annual paper-related savings ranging from \$48.3 million (if issuers who are responsible for 10% of all proxy mailings choose to rely on the notice and access model) to \$241.4 million (if issuers who are responsible for 50% of all proxy mailings choose to rely on the notice and access model).<sup>166</sup> This estimate excludes the

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<sup>162</sup> According to ADP data, the 2006 proxy season extended from February 15, 2006 to May 1, 2006.

<sup>163</sup> 85.3 million mailings x \$5.64/mailing = \$481.2 million.

<sup>164</sup> According to ADP, in 2005, 90,013,175 of 179,833,774, or 50%, of proxy pieces were mailed during the 2005 proxy season.

<sup>165</sup> \$481.2 million / 50% = \$962.4 million.

<sup>166</sup> This range of potential cost savings depends on data on proxy material production, home printing costs, and first-class postage rates provided by Lexecon and ADP, and supplemented with modest 2006 USPS postage rate discounts. The fixed costs of notice and proxy material production are estimated to be \$2.36 per shareholder. The variable costs of fulfilling a paper requests, including handling, paper, printing and postage, are

effect of the provision of the amendments that will allow shareholders to make a permanent request for paper copies. That provision will enable issuers and other soliciting persons to take advantage of bulk printing and mailing rates for those requesting shareholders, and therefore should reduce the on-demand costs reflected in these calculations.<sup>167</sup>

We estimate that approximately 19% of shareholders will request paper copies. Commenters provided alternate estimates. For example, Computershare, a large transfer agent, estimated that less than 10% of shareholders would request paper copies.<sup>168</sup> According to a survey conducted by Forrester Research for ADP, 12% of shareholders report that they would always take extra steps to get their proxy materials, and as many as 68% of shareholders report that they would take extra steps to get their proxy materials in paper at least some of the time. The same survey also finds that 82% of shareholders report that they look at their proxy materials at least some of the time. These survey results suggest that shareholders may review proxy materials even if they do not vote.

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estimated to be \$6.11 per copy requested. Assumptions about percentages of shareholders requesting paper copies are derived from Forrester survey data furnished by ADP and adjusted for the reported likelihood that an investor will take extra steps to get proxy materials. Our estimate of the total number of shareholders is based on data provided by ADP and SIA. According to SIA's comment letter, 78.49% of shareholders held their shares in street name. We estimate that the total number of proxy pieces mailed equals the number of pieces mailed to beneficial shareholders by ADP in 2005 divided by 78.49%, which equals  $179,833,774 / 78.49\%$ , or 229,116,797.

<sup>167</sup> ADP commissioned a study by Lexecon to provide estimates for the total net cost/savings of the amendments to issuers. Lexecon's study relied on 2005 postage rates with no first-class mail discounts and a higher share of color printing at home than we assume above. It estimated that if all issuers adopt the notice and access model, if 9% of shareholders choose to print the materials at home, and 19% choose to have paper copies sent to them, then the amendments would produce a net savings of \$205 million for issuers in the aggregate. However, if 20% of shareholders chose to print and 39% chose to request paper copies, the amendments would produce a net cost of \$181 million. See Lexecon comment letter for more details.

<sup>168</sup> See letter from Computershare.

During the 2005 proxy season, only 44% of accounts were voted by beneficial owners. Put differently, 56%, or 84.8 million accounts, did not return requests for voting instructions. Our estimate that 19% of shareholders will request paper copies reflects the diverse estimates suggested by the available data.

Although we expect the savings to be significant, the actual paper-related benefits will be influenced by several factors that we estimate will become less important over time. First, some issuers and other soliciting persons will likely not elect to follow the alternative model. We estimate that issuers who are responsible for between 10% and 50% of all current proxy mailings will adopt the notice and access model during the first year of implementation of the amendments. Several commenters noted that some issuers may not be willing to try the model the first year, but rather will opt to wait and monitor the experience of other issuers that do try the model. Second, to the extent that some shareholders request paper copies of the proxy materials, the benefits of the amendments in terms of savings in printing and mailing costs will be reduced. Issuers are concerned that the cost per paper copy would be significantly greater if they have to mail copies of paper proxy materials to shareholders on an on-demand basis, rather than mailing the paper copies in bulk. Thus, if a significant number of shareholders request paper, the savings will be substantially reduced. Third, after adopting the notice and access model, issuers may face a high degree of uncertainty about the number of requests that they may get for paper proxy materials and may maintain unnecessarily large inventories of paper copies as a precaution. As issuers gain familiarity with the continued use of paper materials and as shareholders become more comfortable with receiving disclosures via the Internet, the number of paper copies are likely to decline, as will issuers' tendency to

print many more copies than ultimately are requested. This will lead to growth in paper-related savings from the rule amendments over time.

Additional benefits will accrue from reductions in the costs of proxy solicitations by persons other than the issuer. Under the amendments, persons other than the issuer also can rely on the notice and access model, but will be able to limit the scope of their proxy solicitations to shareholders who have not requested paper copies of the proxy materials. We expect that the flexibility afforded to persons other than the issuer under the amendments will reduce the cost of engaging in proxy contests, thereby increasing the effectiveness and efficiency of proxy contests as a source of discipline in the corporate governance process.

The effect of the amendments of lessening the costs associated with a proxy contest will be limited by the persistence of other costs, even under the notice and access model. One commenter noted that a large percentage of the costs of effecting a proxy contest go to legal, document preparation, and solicitation fees, while a much smaller percentage of the costs is associated with printing and distribution of materials.<sup>169</sup> However, other commenters suggested that the paper-related cost savings that can be realized from the rule amendments are substantial enough to change the way many contests are conducted.<sup>170</sup>

Finally, some benefits from the amendments may arise from a reduction in what may be regarded as the environmental costs of the proxy solicitation process.<sup>171</sup>

Specifically, proxy solicitation involves the use of a significant amount of paper and

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<sup>169</sup> See letter from ADP.

<sup>170</sup> See letters from CALSTRS, Computershare, ISS, and Swingvote.

<sup>171</sup> See letter from American Forests.

printing ink. Paper production and distribution can adversely affect the environment, due to the use of trees, fossil fuels, chemicals such as bleaching agents, printing ink (which contains toxic metals), and cleanup washes. To the extent that paper producers internalize these costs and the costs are reflected in the price of paper and other materials consumed during the proxy solicitation process, our dollar estimates of the paper-related benefits reflect the elimination of these adverse environmental consequences under the amendments.

#### **D. Costs**

An issuer's decision to use the notice and access model will introduce several new costs into the process of proxy distribution, including the following: (1) the cost of preparing, producing, and sending the Notice to shareholders; (2) the cost of processing shareholders' requests for copies of the proxy materials and maintaining their permanent election preferences; and (3) the cost to shareholders of printing proxy materials at home that would otherwise be printed by issuers.

The paper-related savings to issuers and other soliciting persons discussed under the benefits section above are adjusted for the cost of printing and sending Notices. If Notices are sent by mail, then the mailing costs may vary widely among parties. Postage rates likely would vary from \$0.14 to \$0.39 per Notice mailed, depending on numerous factors. In our estimates of the paper-related benefits above, we assume that each Notice costs a total of \$0.42 to print and mail. Based on data from ADP and SIA, we estimate that issuers and other soliciting persons process a total of 229,116,797 accounts per

year.<sup>172</sup> The alternative model also requires minimal added disclosures in the form of a Notice to shareholders, informing them that the proxy materials are available at a specified Internet Web site. For purposes of the PRA, we have presented the extremely conservative estimate that the preparation and filing costs of the amendments, assuming that all issuers and other soliciting persons elect to follow the procedures, will be approximately \$2,020,475.<sup>173</sup> Under the alternate scenario presented above, these costs could range between \$202,048 if 10% of issuers adopt the model and \$1,010,238 if 50% of issuers adopt. The amendments also require issuers and intermediaries to maintain records of shareholders who have requested paper and e-mail copies for future proxy solicitations. We estimate that this cost to issuers and intermediaries will be approximately \$9,977,500 if all issuers adopt the notice and access model,<sup>174</sup> \$997,500 if 10% of issuers adopt the model, and \$4,988,750 if 50% of issuers adopt the model.

Issuers who adopt the notice and access model and their intermediaries will incur additional processing costs. The amendments will require an intermediary such as a bank, broker-dealer, or other association to follow the notice and access model if an issuer so requests. An intermediary that follows the notice and access model will be

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<sup>172</sup> See [www.ics.adp.com/release11/public\\_site/about/stats.html](http://www.ics.adp.com/release11/public_site/about/stats.html) stating that ADP handled 179,833,774 in fiscal year 2005 and letter from SIA stating that beneficial accounts represent 78.49% of total accounts.

<sup>173</sup> For PRA purposes, we estimate that issuers would spend a total of \$897,975 on outside professionals to prepare this disclosure. We also estimate that issuers would spend a total of 8,980 hours of issuer personnel time preparing this disclosure. We estimate the average hourly cost of issuer personnel time to be \$125, resulting in a total cost of \$1,122,500 for issuer personnel time. This results in a total cost of \$2,020,475 for all issuers. We expect that costs for posting the materials on a Web site will be minimal and are included in this calculation.

<sup>174</sup> For PRA purposes, we estimate that issuers and intermediaries would spend a total of 79,820 hours of issuer and intermediary personnel time maintaining these records. We estimate the average hourly cost of issuer and intermediary personnel time to be \$125, resulting in a total cost of \$9,977,500 for issuer and intermediary personnel time.

required to prepare its own Notice to beneficial owners, along with instructions on when and how to request paper copies and the website where the beneficial owner can access his or her request for voting instructions. Since issuers reimburse intermediaries for their reasonable expenses of forwarding proxy materials and intermediaries and their agents already have systems to prepare and deliver requests for voting instructions, we do not expect the intermediaries' role in sending their Notices to beneficial owners to significantly affect the costs associated with the rule.

Under the notice and access model, a beneficial owner must request a copy of proxy materials from its intermediary rather than from the issuer. The costs of collecting and processing requests from beneficial owners may be significant, particularly if the intermediary receives the requests of beneficial owners associated with many different issuers that specify different methods of furnishing the proxy. We expect that these processing costs will be highest in the first year after adoption but will subsequently decline as intermediaries develop the necessary systems and procedures and as beneficial owners increasingly become comfortable with accessing proxy materials online. In addition, the final rules permit a beneficial owner to specify its preference on an account-wide basis, which should reduce the cost of processing requests for copies. These costs are ultimately paid by the issuer and therefore would be included in an issuer's assessment of whether to adopt the alternative model.

Shareholders obtaining proxy materials online would incur any necessary costs associated with gaining access to the Internet. In addition, some shareholders may choose to print out the posted materials, which will entail paper and printing costs. We estimate that approximately 10% of all shareholders will print out the posted materials at

home at an estimated cost of \$7.05 per proxy package. Based on these assumptions, the amendments are estimated to produce annual home printing costs ranging from \$16 million (if issuers who are responsible for 10% of all current proxy mailings choose to rely on the notice and access model) to \$80 million (if issuers who are responsible for 50% of all current proxy mailings choose to rely on the notice and access model).<sup>175</sup> Investors have the option to incur no additional cost by either accessing the proxy materials online or requesting paper copies of the materials from the issuer.

## **VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation**

Section 23(a)(2) of the Exchange Act<sup>176</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act<sup>177</sup> and Section 2(c) of the Investment Company Act of 1940<sup>178</sup> require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote

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<sup>175</sup> This range of potential home printing costs depends on data provided by Lexecon and ADP. See letter from ADP. The Lexecon data was included in the ADP comment letter. To calculate home printing cost, we assume that 50% of annual report pages are printed in color and 100% of proxy statement pages are printed in black and white. The estimated percentage of shareholders printing at home is derived from Forrester survey data furnished by ADP and adjusted for the reported likelihood that an investor will take extra steps to get proxy materials. Total number of shareholders estimated as above based on data provided by ADP and SIA. See letters from ADP and SIA.

<sup>176</sup> 15 U.S.C. 78w(a)(2).

<sup>177</sup> 15 U.S.C. 78c(f).

<sup>178</sup> 15 U.S.C. 80a-2(c).

efficiency, competition, and capital formation. We have also discussed other impacts of the amendments in our Cost-Benefit, Paperwork Reduction Act and Final Regulatory Flexibility Act Analyses.

The amendments to the proxy rules are intended to improve efficiency by providing an alternative for issuers and other soliciting persons that could reduce the cost of soliciting proxies and sending information statements regarding shareholder meetings. Currently, many issuers must devote a significant amount of time and resources to proxy mailings. Similarly, undertaking a proxy contest is often a very costly endeavor. We expect that the amendments will reduce the time and resources related to such distributions. These costs include reimbursing intermediaries for their part in the process.

As noted elsewhere in this release, commenters expressed concern that the amendments might reduce shareholder participation in the proxy voting process, making issuers more dependent on broker discretionary voting. Such a result would affect the efficiency of the current proxy voting process. We have made revisions to the amendments to minimize such effect, by making it easier for shareholders to continue to receive paper copies of the proxy materials. Similarly, there was concern that the amendments would increase the risk of shareholders conducting frivolous proxy contests. We have also revised the final rules to minimize this possibility, by eliminating the proposed conditional solicitation.<sup>179</sup>

Some commenters were concerned that the added procedures would complicate the proxy distribution process, reducing the efficiency of the process. The final rules are voluntary. No issuer or other soliciting person is required to rely on the notice and access

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See Section III.C.1 of Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

model. Those that choose to rely on the model presumably have determined that the additional procedures that they must follow would reduce their cost of soliciting proxies, thereby increasing the efficiency of the process.

We considered the effects that the amendments would have on capital formation. The final rules do not directly affect the ability of issuers to raise capital. However, they are intended to reduce the cost of soliciting proxies. In addition, they facilitate proxy disclosure via the Internet, which may improve the manner in which investors receive those disclosures, thereby improving shareholder relations.

We considered the possible effects of the amendments on competition. As noted elsewhere in this release, companies in, and related to, the financial printing industry were concerned about the negative effects that the rules may have on that industry. Conversely, these rules may create alternative industries that promote more user-friendly, computer-based systems for interaction with shareholders, thus creating new jobs and industries in this field.

#### **VIII. Final Regulatory Flexibility Analysis**

This Final Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to amendments to the proxy rules under the Exchange Act that will provide an alternative model for issuers and other persons soliciting proxies to satisfy certain of their obligations under the Commission's proxy rules. An Initial Regulatory Flexibility Analysis (IRFA) was prepared in accordance with the Regulatory Flexibility Act in conjunction with the proposing release. The proposing release included, and solicited comment on, the IRFA.

#### **A. Need for the Amendments**

On December 8, 2005, we proposed amendments to the rules regarding provision of proxy materials to shareholders.<sup>180</sup> We are adopting those amendments, substantially as proposed, but with a few modifications in response to public comment. Specifically, the amendments create an alternative notice and access model by which issuers and other soliciting persons can electronically furnish their proxy materials to shareholders. The amendments are intended to put into place processes that will provide shareholders with notice of, and access to, proxy materials while taking advantage of technological developments and the growth of the Internet and electronic communications. Issuers that rely on the amendments may be able to significantly lower the costs of their proxy solicitations that ultimately are borne by shareholders. The fact that the amendments also apply to a soliciting person other than the issuer might help to reduce the costs of engaging in a proxy contest.

The amendments also have the potential to improve the ability of shareholders to participate meaningfully in the proxy process by reducing the cost of undertaking a proxy contest and may increase management's accountability and responsiveness to shareholders due to heightened concern about the possibility of a proxy contest. This, in turn, may enhance the value of shareholders' investments.

#### **B. Significant Issues Raised by Public Comment**

In the proposing release, we requested comment on any aspect of the Initial Regulatory Flexibility Act Analysis, including the number of small entities that would be affected by the proposals, and both the qualitative and quantitative nature of the impact.

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Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

We did not receive comment on the number of small entities that would be affected by the proposals. Also, no commenters noted any difference in the potential effect of the amendments on small entities as opposed to other entities.

One commenter remarked that smaller companies depend more heavily on broker discretionary voting than larger companies in order to meet state law quorum requirements.<sup>181</sup> Although the new rules do not affect the NYSE's broker discretionary voting rule, that commenter noted that if the final rules reduce shareholder voting, such smaller companies would become even more dependent on broker discretionary voting. As noted elsewhere in this release, we have made revisions to the amendments to minimize such effect, by making it easier for shareholders to continue to receive paper copies of the proxy materials.

### **C. Small Entities Subject to the Amendments**

Exchange Act Rule 0-10(a)<sup>182</sup> defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 2,500 public companies, other than investment companies, that may be considered small entities.

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>183</sup> Approximately 157 registered investment companies meet this

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<sup>181</sup> See letter from ABC.

<sup>182</sup> 17 CFR 240.0-10(a).

<sup>183</sup> See Rule 0-10 under the Investment Company Act of 1940 [17 CFR 270.0-10].

definition. Moreover, approximately 53 business development companies may be considered small entities.

Paragraph (c)(1) of Rule 0-10 under the Exchange Act<sup>184</sup> states that the term “small business” or “small organization,” when referring to a broker-dealer, means a broker or dealer that had 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 §240.17a-5(d); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. As of 2005, the Commission estimates that there were approximately 910 broker-dealers that qualified as small entities as defined above.<sup>185</sup> Small Business Administration regulations define “small entities” to include banks and savings associations with total assets of \$165 million or less.<sup>186</sup> The Commission estimates that the rules will apply to approximately 9,475 banks, approximately 5,816 of which could be considered small banks with assets of \$165 million or less.

No issuer is required to follow the notice and access model. However, we expect that many issuers will choose to follow the alternative model because of the substantial cost savings that they may realize. These issuers likely will include many small entities. Broker-dealer and bank intermediaries are required to comply with the notice and access

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<sup>184</sup> 17 CFR 240.0-10(c)(1).

<sup>185</sup> These numbers are based on a review by the Commission’s Office of Economic Analysis of 2005 Financial and Operational Combined Uniform Single (FOCUS) Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent in their FOCUS Report filings.

<sup>186</sup> 13 CFR 121.201.

model if an issuer or other soliciting person requests such intermediaries to follow the alternative model.

**D. Reporting, Recordkeeping and Other Compliance Requirements**

If an issuer chooses to follow the model, it will be required to prepare, file, and furnish a Notice to shareholders. Similarly, upon request from an issuer or other soliciting person, a broker-dealer or bank intermediary will be required to prepare and furnish its own Notice to beneficial owners. These Notices must include factual information that is readily available to the issuer and intermediary. An issuer relying on the notice and access model also will be required to provide copies of the proxy materials to requesting shareholders and to maintain a Web site on which to post the proxy materials. Intermediaries will be required to forward copies of the proxy materials to requesting beneficial owners and to maintain a Web site on which to post its request for voting instructions. Those Web sites must be maintained in a manner to ensure that the anonymity of persons accessing the Web sites is preserved. Finally, issuers and intermediaries must maintain records regarding which shareholders have indicated a preference to receive paper or e-mail copies of the proxy materials in the future.

**E. Agency Action to Minimize Effect on Small Entities**

Compliance with the alternative notice and access model is voluntary for issuers. An issuer that is a small entity, like other types of entities subject to the proxy rules, need not elect to follow the alternative model. This flexibility to comply with traditional methods of distributing proxy materials to shareholders or to comply with the notice and access model will allow a small entity to choose the compliance means that will be most cost effective for its particular situation. It is likely that only the issuers that believe they

will realize cost savings or other benefits as a result of following the notice and access model will choose to do so.

Broker-dealer and bank intermediaries that are small entities must comply with the requirements of the voluntary model upon request from an issuer or other soliciting person. However, an intermediary is not required to forward proxy materials to beneficial owners unless the issuer or other soliciting person provides assurance of reimbursement of the intermediary's reasonable expenses incurred in connection with forwarding those materials. Therefore, any costs imposed on intermediaries by the rules will be borne by the issuer or other soliciting person, and ultimately shareholders. Exempting broker-dealers and banks that are small entities would lead to inconsistent means by which beneficial owners receive their proxy materials, which we believe would not be appropriate.

We considered alternatives, such as permitting an intermediary to merely forward an issuer's Notice rather than preparing its own Notice and permitting beneficial owners to request copies directly from the issuer. However, we believe that those alternatives create a high likelihood of confusion with respect to whether a beneficial owner would be entitled to execute a proxy card rather than provide voting instructions to his or her intermediary. To prevent such confusion, we have decided that such alternatives would not be appropriate.

#### **IX. Statutory Basis and Text of Amendments**

We are adopting the amendments pursuant to Sections 3(b), 10, 13, 14, 15, 23(a), and 36 of the Securities Exchange Act of 1934, as amended, and Sections 20(a), 30, and 38 of the Investment Company Act of 1940, as amended.

## List of Subjects

### 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

### 17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

2. Amend §240.14a-2 by:

- a. Removing the period and adding a semicolon at the end of paragraph (b)(3)(ii); and
- b. Revising paragraph (b)(3)(iv).

The revision reads as follows:

### §240.14a-2 Solicitations to which §240.14a-3 to §240.14a-15 apply.

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(iv) The proxy voting advice is not furnished on behalf of any person soliciting proxies or on behalf of a participant in an election subject to the provisions of §240.14a-12(c); and

\* \* \* \* \*

3. Amend §240.14a-3 by:

a. Revising paragraphs (a), (e)(1)(i), the introductory text of paragraphs (e)(1)(ii)(A) and (e)(1)(ii)(B)(2), paragraphs (e)(1)(ii)(B)(2)(ii), (e)(1)(ii)(B)(2)(iii), (e)(1)(ii)(B)(3), (e)(1)(iii), and (e)(2); and

b. Revising the term “annual report” to read “annual report to security holders” in paragraph (b)(13).

The revisions read as follows:

**§240.14a-3 Information to be furnished to security holders.**

(a) No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with:

(1) A publicly-filed preliminary or definitive written proxy statement containing the information specified in Schedule 14A (§240.14a-101);

(2) A publicly-filed preliminary or definitive proxy statement, in the form and manner described in §240.14a-16, containing the information specified in Schedule 14A (§240.14a-101); or

(3) A preliminary or definitive written proxy statement included in a registration statement filed under the Securities Act of 1933 on Form S-4 or F-4 (§239.25 or §239.34 of this chapter) or Form N-14 (§239.23 of this chapter) and containing the information specified in such Form.

\* \* \* \* \*

(e)(1)(i) A registrant will be considered to have delivered an annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as described in §240.14a-16, to all security holders of record who share an address if:

(A) The registrant delivers one annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, to the shared address;

(B) The registrant addresses the annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, to the security holders as a group (for example, "ABC Fund [or Corporation] Security Holders," "Jane Doe and Household," "The Smith Family"), to each of the security holders individually (for example, "John Doe and Richard Jones") or to the security holders in a form to which each of the security holders has consented in writing;

Note to paragraph (e)(1)(i)(B): Unless the registrant addresses the annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials to the security holders as a group or to each of the security holders individually, it must obtain, from each security holder to be included in the househanded group, a separate affirmative written consent to the specific form of address the registrant will use.

(C) The security holders consent, in accordance with paragraph (e)(1)(ii) of this section, to delivery of one annual report to security holders or proxy statement, as applicable;

(D) With respect to delivery of the proxy statement or Notice of Internet Availability of Proxy Materials, the registrant delivers, together with or subsequent to

delivery of the proxy statement, a separate proxy card for each security holder at the shared address; and

(E) The registrant includes an undertaking in the proxy statement to deliver promptly upon written or oral request a separate copy of the annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, to a security holder at a shared address to which a single copy of the document was delivered.

(ii) Consent. (A) Affirmative written consent. Each security holder must affirmatively consent, in writing, to delivery of one annual report to security holders or proxy statement, as applicable. A security holder's affirmative written consent will be considered valid only if the security holder has been informed of:

\* \* \* \* \*

(B) \* \* \*

(2) The registrant has sent the security holder a notice at least 60 days before the registrant begins to rely on this section concerning delivery of annual reports to security holders, proxy statements or Notices of Internet Availability of Proxy Materials to that security holder. The notice must:

\* \* \* \* \*

(ii) State that only one annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, will be delivered to the shared address unless the registrant receives contrary instructions;

(iii) Include a toll-free telephone number, or be accompanied by a reply form that is pre-addressed with postage provided, that the security holder can use to notify the

registrant that the security holder wishes to receive a separate annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials;

\* \* \* \* \*

(3) The registrant has not received the reply form or other notification indicating that the security holder wishes to continue to receive an individual copy of the annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials, as applicable, within 60 days after the registrant sent the notice required by paragraph (e)(1)(ii)(B)(2) of this section; and

\* \* \* \* \*

(iii) Revocation of consent. If a security holder, orally or in writing, revokes consent to delivery of one annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials to a shared address, the registrant must begin sending individual copies to that security holder within 30 days after the registrant receives revocation of the security holder's consent.

\* \* \* \* \*

(2) Notwithstanding paragraphs (a) and (b) of this section, unless state law requires otherwise, a registrant is not required to send an annual report to security holders, proxy statement or Notice of Internet Availability of Proxy Materials to a security holder if:

- (i) An annual report to security holders and a proxy statement, or a Notice of Internet of Availability of Proxy Materials, for two consecutive annual meetings; or
- (ii) All, and at least two, payments (if sent by first class mail) of dividends or interest on securities, or dividend reinvestment confirmations, during a twelve month

period, have been mailed to such security holder's address and have been returned as undeliverable. If any such security holder delivers or causes to be delivered to the registrant written notice setting forth his then current address for security holder communications purposes, the registrant's obligation to deliver an annual report to security holders, a proxy statement or a Notice of Internet Availability of Proxy Materials under this section is reinstated.

\* \* \* \* \*

4. Amend §240.14a-4 by:
  - a. Removing the authority citation following the section;
  - b. Revising the word "mailed" to read "sent" in the first sentence of paragraph (c)(1); and
  - c. Revising the word "mails" to read "sends" in the last sentence of paragraph (c)(1).
5. Amend §240.14a-7 by:
  - a. Revising paragraphs (a)(2)(i) and (a)(2)(ii);
  - b. Adding paragraph (a)(2)(iii); and
  - c. In the "Notes to §240.14a-7", revising the numerical designation "1." to read "Note 1 to §240.14a-8", revising the numerical designation "2." to read "Note 2 to §240.14a-7" and adding "Note 3 to §240.14a-7".

The revisions and additions read as follows:

**§240.14a-7 Obligations of registrants to provide a list of, or mail soliciting material to, security holders.**

\* \* \* \* \*

(a) \* \* \*

(2) \* \* \*

(i) Send copies of any proxy statement, form of proxy, or other soliciting material, including a Notice of Internet Availability of Proxy Materials (as described in §240.14a-16), furnished by the security holder to the record holders, including banks, brokers, and similar entities, designated by the security holder. A sufficient number of copies must be sent to the banks, brokers, and similar entities for distribution to all beneficial owners designated by the security holder. The security holder may designate only record holders and/or beneficial owners who have not requested paper and/or e-mail copies of the proxy statement. If the registrant has received affirmative written or implied consent to deliver a single proxy statement to security holders at a shared address in accordance with the procedures in §240.14a-3(e)(1), a single copy of the proxy statement or Notice of Internet Availability of Proxy Materials furnished by the security holder shall be sent to that address, provided that if multiple copies of the Notice of Internet Availability of Proxy Materials are furnished by the security holder for that address, the registrant shall deliver those copies in a single envelope to that address. The registrant shall send the security holder material with reasonable promptness after tender of the material to be sent, envelopes or other containers therefore, postage or payment for postage and other reasonable expenses of effecting such distribution. The registrant shall not be responsible for the content of the material; or

(ii) Deliver the following information to the requesting security holder within five business days of receipt of the request:

(A) A reasonably current list of the names, addresses and security positions of the record holders, including banks, brokers and similar entities holding securities in the

same class or classes as holders which have been or are to be solicited on management's behalf, or any more limited group of such holders designated by the security holder if available or retrievable under the registrant's or its transfer agent's security holder data systems;

(B) The most recent list of names, addresses and security positions of beneficial owners as specified in §240.14a-13(b), in the possession, or which subsequently comes into the possession, of the registrant;

(C) The names of security holders at a shared address that have consented to delivery of a single copy of proxy materials to a shared address, if the registrant has received written or implied consent in accordance with §240.14a-3(e)(1); and

(D) If the registrant has relied on §240.14a-16, the names of security holders who have requested paper copies of the proxy materials for all meetings and the names of security holders who, as of the date that the registrant receives the request, have requested paper copies of the proxy materials only for the meeting to which the solicitation relates.

(iii) All security holder list information shall be in the form requested by the security holder to the extent that such form is available to the registrant without undue burden or expense. The registrant shall furnish the security holder with updated record holder information on a daily basis or, if not available on a daily basis, at the shortest reasonable intervals; provided, however, the registrant need not provide beneficial or record holder information more current than the record date for the meeting or action.

\* \* \* \* \*

Notes to §240.14a-7.

\* \* \* \* \*

Note 3 to §240.14a-7. If the registrant is sending the requesting security holder's materials under §240.14a-7 and receives a request from the security holder to furnish the materials in the form and manner described in §240.14a-16, the registrant must accommodate that request.

6. Amend §240.14a-8 by revising the word "mail" to read "send" in the last sentence of paragraph (e)(2) and in paragraph (e)(3) and the word "mails" to read "sends" in the introductory text of paragraph (m)(3).

7. Amend §240.14a-12 by revising the term "annual report" to read "annual report to security holders" in the heading of paragraph (c)(1) and the first sentence of paragraph (c)(1).

8. Amend §240.14a-13 by revising the word "mailing" to read "sending" in paragraph (a)(5) and the word "mail" to read "send" in Note 2 following paragraph (a) and in paragraph (c), each time it appears.

9. Add §240.14a-16 to read as follows:

**§240.14a-16 Internet availability of proxy materials.**

(a)(1) A registrant may furnish a proxy statement pursuant to §240.14a-3(a), or an annual report to security holders pursuant to §240.14a-3(b), to a security holder by sending the security holder a Notice of Internet Availability of Proxy Materials, as described in this section, 40 calendar days or more prior to the security holder meeting date, or if no meeting is to be held, 40 calendar days or more prior to the date the votes, consents or authorizations may be used to effect the corporate action, and complying with all other requirements of this section.

(2) If the registrant chooses to provide the proxy statement or annual report to security holders to beneficial owners pursuant to this section, it must provide the record holder or respondent bank with all information listed in paragraph (d) of this section in sufficient time for the record holder or respondent bank to prepare, print and send a Notice of Internet Availability of Proxy Materials to beneficial owners at least 40 calendar days before the meeting date.

(b)(1) All materials identified in the Notice of Internet Availability of Proxy Materials must be publicly accessible, free of charge, at the Web site address specified in the notice on or before the time that the notice is sent to the security holder and such materials must remain available on that Web site through the conclusion of the meeting of security holders.

(2) All additional soliciting materials sent to security holders or made public after the Notice of Internet Availability of Proxy Materials has been sent must be made publicly accessible at the specified Web site address no later than the day on which such materials are first sent to security holders or made public.

(3) The Web site address relied upon for compliance under this section may not be the address of the Commission's electronic filing system.

(4) The registrant must provide security holders with a means to execute a proxy as of the time the Notice of Internet Availability of Proxy Materials is first sent to security holders.

(c) The materials must be presented on the Web site in a format, or formats, convenient for both reading online and printing on paper.

(d) The Notice of Internet Availability of Proxy Materials must contain the following:

(1) A prominent legend in bold-face type that states:

**“Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].**

1. This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.

2. The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].

3. If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery.”;

(2) The date, time, and location of the meeting, or if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;

(3) A clear and impartial identification of each separate matter intended to be acted on and the soliciting person’s recommendations regarding those matters, but no supporting statements;

(4) A list of the materials being made available at the specified Web site;

(5) A toll-free telephone number, an e-mail address, and an Internet Web site where the security holder can request a copy of the proxy statement, annual report to

security holders, and form of proxy, relating to all of the registrant's future security holder meetings and for the particular meeting to which the proxy materials being furnished relate;

(6) Any control/identification numbers that the security holder needs to access his or her form of proxy;

(7) Instructions on how to access the form of proxy, provided that such instructions do not enable a security holder to execute a proxy without having access to the proxy statement and, if required by §240.14a-3(b), the annual report to security holders; and

(8) Information on how to obtain directions to be able to attend the meeting and vote in person.

(e)(1) The Notice of Internet Availability of Proxy Materials may not be incorporated into, or combined with, another document, except that it may be incorporated into, or combined with, a notice of security holder meeting required under state law, unless state law prohibits such incorporation or combination.

(2) The Notice of Internet Availability of Proxy Materials may contain only the information required by paragraph (d) of this section and any additional information required to be included in a notice of security holders meeting under state law; provided that:

(i) The registrant must revise the information on the Notice of Internet Availability of Proxy Materials, including any title to the document, to reflect the fact that:

(A) The registrant is conducting a consent solicitation rather than a proxy solicitation; or

(B) The registrant is not soliciting proxy or consent authority, but is furnishing an information statement pursuant to §240.14c-2; and

(ii) The registrant may include a statement on the Notice to educate security holders that no personal information other than the identification or control number is necessary to execute a proxy.

(f)(1) Except as provided in paragraph (h) of this section, the Notice of Internet Availability of Proxy Materials must be sent separately from other types of security holder communications and may not accompany any other document or materials, including the form of proxy.

(2) Notwithstanding paragraph (f)(1) of this section, the registrant may accompany the Notice of Internet Availability of Proxy Materials with:

(i) A pre-addressed, postage-paid reply card for requesting a copy of the proxy materials; and

(ii) A copy of any notice of security holder meeting required under state law if that notice is not combined with the Notice of Internet Availability of Proxy Materials.

(g) Plain English.

(1) To enhance the readability of the Notice of Internet Availability of Proxy Materials, the registrant must use plain English principles in the organization, language, and design of the notice.

(2) The registrant must draft the language in the Notice of Internet Availability of Proxy Materials so that, at a minimum, it substantially complies with each of the following plain English writing principles:

- (i) Short sentences;
- (ii) Definite, concrete, everyday words;
- (iii) Active voice;
- (iv) Tabular presentation or bullet lists for complex material, whenever possible;
- (v) No legal jargon or highly technical business terms; and
- (vi) No multiple negatives.

(3) In designing the Notice of Internet Availability of Proxy Materials, the registrant may include pictures, logos, or similar design elements so long as the design is not misleading and the required information is clear.

(h) The registrant may, at its discretion, choose to furnish some proxy materials pursuant to §240.14a-3(a)(1) and other proxy materials pursuant to this section, provided that the registrant may not send a form of proxy to security holders until 10 calendar days or more after the date it sent the Notice of Internet Availability of Proxy Materials to security holders, unless the form of proxy is accompanied or has been preceded by a copy of the proxy statement and any annual report to security holders that is required by §240.14a-3(b) through the same delivery medium. If the registrant sends a form of proxy after the expiration of such 10-day period and the form of proxy is not accompanied or preceded by a copy, via the same medium, of the proxy statement and any annual report to security holders that is required by §240.14a-3(b), then the registrant

shall accompany the form of proxy with a Notice of Internet Availability of Proxy Materials.

(i) The registrant must file a form of the Notice of Internet Availability of Proxy Materials with the Commission pursuant to §240.14a-6(b) no later than the date that the registrant first sends the notice to security holders.

(j) Obligation to provide copies.

(1) The registrant must send, at no cost to the record holder or respondent bank and by U.S. first class mail or other reasonably prompt means, a paper copy of the proxy statement, information statement, annual report to security holders, and form of proxy (to the extent each of those documents is applicable) to any record holder or respondent bank requesting such a copy within three business days after receiving a request for a paper copy.

(2) The registrant must send, at no cost to the record holder or respondent bank and via e-mail, an electronic copy of the proxy statement, information statement, annual report to security holders, and form of proxy (to the extent each of those documents is applicable) to any record holder or respondent bank requesting such a copy within three business days after receiving a request for an electronic copy via e-mail.

(3) The registrant is required to provide copies of the proxy materials pursuant to paragraphs (j)(1) and (j)(2) for one year after the conclusion of the meeting or corporate action to which the proxy materials relate.

(4) The registrant must maintain records of security holder requests to receive materials in paper or via e-mail for future solicitations and must continue to provide

copies of the materials to a security holder who has made such a request until the security holder revokes such request.

(k) Security holder information.

(1) A registrant or its agent shall maintain the Internet Web site on which it posts its proxy materials in a manner that does not infringe on the anonymity of a person accessing such Web site.

(2) The registrant and its agents shall not use any e-mail address obtained from a security holder solely for the purpose of requesting a copy of proxy materials pursuant to paragraph (j) for any purpose other than to send a copy of those materials to that security holder. The registrant shall not disclose such information to any person other than an employee or agent to the extent necessary to send a copy of the proxy materials pursuant to paragraph (j).

(l) A person other than the registrant may solicit proxies pursuant to the conditions imposed on registrants by this section, provided that:

(1) A soliciting person other than the registrant is required to provide copies of its proxy materials only to security holders to whom it has sent a Notice of Internet Availability of Proxy Materials; and

(2) A soliciting person other than the registrant must send its Notice of Internet Availability of Proxy Materials by the later of:

(i) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; or

(ii) 10 calendar days after the date that the registrant first send its proxy statement or Notice of Internet Availability of Proxy Materials to security holders.

(3) Content of the soliciting person's Notice of Internet Availability of Proxy Materials.

(i) If, at the time a soliciting person other than the registrant sends its Notice of Internet Availability of Proxy Materials, the soliciting person is not aware of all matters on the registrant's agenda for the meeting of security holders, the soliciting person's Notice on Internet Availability of Proxy Materials must provide a clear and impartial identification of each separate matter on the agenda to the extent known by the soliciting person at that time. The soliciting person's notice also must include a clear statement indicating that there may be additional agenda items of which the soliciting person is not aware and that the security holder cannot direct a vote for those items on the soliciting person's proxy card provided at that time.

(ii) If a soliciting person other than the registrant sends a form of proxy not containing all matters intended to be acted upon, the Notice of Internet Availability of Proxy Materials must clearly state whether execution of the form of proxy will invalidate a security holder's prior vote on matters not presented on the form of proxy.

(m) This section shall not apply to a proxy solicitation in connection with a business combination transaction, as defined in §230.165 of this chapter.

(n) This section provides a non-exclusive alternative by which an issuer or other person may furnish a proxy statement pursuant to §240.14a-3(a) or an annual report to security holders pursuant to §240.14a-3(b) to a security holder. This section does not affect the availability of any other means by which an issuer or other person may furnish

a proxy statement pursuant to §240.14a-3(a), or an annual report to security holders pursuant to §240.14a-3(b), to a security holder.

10. Amend §240.14a-101 by:

a. Revising the term “annual report” to read “annual report on Form 10-K or Form 10-KSB” in Instruction 1 to paragraph (d)(2)(ii)(L) of Item 7;

b. Revising the word “mail” to read “send” in Instruction 2 to paragraph (d)(2)(ii)(L) of Item 7; and

c. Revising Item 23.

The revision reads as follows.

**§240.14a-101 Schedule 14A. Information required in proxy statement.**

\* \* \* \* \*

Item 23. Delivery of documents to security holders sharing an address. If one annual report to security holders, proxy statement, or Notice of Internet Availability of Proxy Materials is being delivered to two or more security holders who share an address in accordance with §240.14a-3(e)(1), furnish the following information:

(a) State that only one annual report to security holders, proxy statement, or Notice of Internet Availability of Proxy Materials, as applicable, is being delivered to multiple security holders sharing an address unless the registrant has received contrary instructions from one or more of the security holders;

(b) Undertake to deliver promptly upon written or oral request a separate copy of the annual report to security holders, proxy statement, or Notice of Internet Availability of Proxy Materials, as applicable, to a security holder at a shared address to which a single copy of the documents was delivered and provide instructions as to how a

security holder can notify the registrant that the security holder wishes to receive a separate copy of an annual report to security holders, proxy statement, or Notice of Internet Availability of Proxy Materials, as applicable;

(c) Provide the phone number and mailing address to which a security holder can direct a notification to the registrant that the security holder wishes to receive a separate annual report to security holders, proxy statement, or Notice of Internet Availability of Proxy Materials, as applicable, in the future; and

(d) Provide instructions how security holders sharing an address can request delivery of a single copy of annual reports to security holders, proxy statements, or Notices of Internet Availability of Proxy Materials if they are receiving multiple copies of annual reports to security holders, proxy statements, or Notices of Internet Availability of Proxy Materials.

11. Amend §240.14b-1 by:

- a. Revising paragraphs (b)(2) including the Note and (c)(2)(i);
- b. Revising the term “annual reports” to read “annual reports to security holders” in paragraphs (c)(2)(ii) and (c)(3);
- c. Revising the term “annual report” to read “annual report to security holders” in paragraph (c)(2)(ii);
- d. Revising the word “mail” to read “send” in paragraph (c)(2)(ii); and
- e. Adding paragraphs (d) and (e).

The revisions and additions read as follows:

**§240.14b-1 Obligation of registered brokers and dealers in connection with the prompt forwarding of certain communications to beneficial owners.**

(b) \* \* \*

(2) The broker or dealer shall, upon receipt of the proxy, other proxy soliciting material, information statement, and/or annual report to security holders from the registrant or other soliciting person, forward such materials to its customers who are beneficial owners of the registrant's securities no later than five business days after receipt of the proxy material, information statement or annual report to security holders.

Note to Paragraph (b)(2): At the request of a registrant, or on its own initiative so long as the registrant does not object, a broker or dealer may, but is not required to, deliver one annual report to security holders, proxy statement, information statement, or Notice of Internet Availability of Proxy Materials to more than one beneficial owner sharing an address if the requirements set forth in §240.14a-3(e)(1) (with respect to annual reports to security holders, proxy statements, and Notices of Internet Availability of Proxy Materials) and §240.14c-3(c) (with respect to annual reports to security holders, information statements, and Notices of Internet Availability of Proxy Materials) applicable to registrants, with the exception of §240.14a-3(e)(1)(i)(E), are satisfied instead by the broker or dealer.

(c) \* \* \*

(2) \* \* \*

(i) Its obligations under paragraphs (b)(2), (b)(3) and (d) of this section if the registrant or other soliciting person, as applicable, does not provide assurance of reimbursement of the broker's or dealer's reasonable expenses, both direct and indirect, incurred in connection with performing the obligations imposed by paragraphs (b)(2), (b)(3) and (d) of this section; or

\* \* \* \* \*

(d) Compliance with §240.14a-16. If a registrant or other soliciting person informs the broker or dealer that it intends to rely on §240.14a-16 to furnish proxy materials to beneficial owners and provides all of the relevant information listed in §240.14a-16(d) to the broker or dealer, the broker or dealer shall:

(1) Prepare and send a Notice of Internet Availability of Proxy Materials containing the information required in paragraph (e) of this section to beneficial owners no later than:

(i) With respect to a registrant, 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; and

(ii) With respect to a soliciting person other than the registrant, the later of:

(A) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; or

(B) 10 calendar days after the date that the registrant first sends its proxy statement or Notice of Internet Availability of Proxy Materials to security holders.

(2) Establish a Web site at which beneficial owners are able to access the broker or dealer's request for voting instructions and, at the broker or dealer's option, establish a Web site at which beneficial owners are able to access the proxy statement and other soliciting materials, provided that such Web sites are maintained in a manner consistent with paragraphs (b), (c), and (k) of §240.14a-16;

(3) Upon receipt of a request from the registrant or other soliciting person, send to security holders specified by the registrant or other soliciting person a copy of the

request for voting instructions accompanied by a copy of the intermediary's Notice of Internet Availability of Proxy Materials 10 calendar days or more after the broker or dealer sends its Notice of Internet Availability of Proxy Materials pursuant to paragraph (d)(1); and

(4) Upon receipt of a request for a copy of the materials from a beneficial owner:

(i) Request a copy of the soliciting materials from the registrant or other soliciting person, in the form requested by the beneficial owner, within three business days after receiving the beneficial owner's request;

(ii) Forward a copy of the soliciting materials to the beneficial owner, in the form requested by the beneficial owner, within three business days after receiving the materials from the registrant or other soliciting person; and

(iii) Maintain records of security holder requests to receive a paper or e-mail copy of the proxy materials in connection with future proxy solicitations and provide copies of the proxy materials to a security holder who has made such a request for all securities held in the account of that security holder until the security holder revokes such request.

(e) Content of Notice of Internet Availability of Proxy Materials. The broker or dealer's Notice of Internet Availability of Proxy Materials shall:

(1) Include all information, as it relates to beneficial owners, required in a registrant's Notice of Internet Availability of Proxy Materials under §240.14a-16(d), provided that the broker or dealer shall provide its own, or its agent's, toll-free telephone

number, an e-mail address, and an Internet Web site to service requests for copies from beneficial owners;

(2) Include a brief description, if applicable, of the rules that permit the broker or dealer to vote the securities if the beneficial owner does not return his or her voting instructions; and

(3) Otherwise be prepared and sent in a manner consistent with paragraphs (e), (f), and (g) of §240.14a-16.

12. Amend §240.14b-2 by:

a. Revising the introductory text of paragraph (b)(3), the Note to paragraph (b)(3), and paragraph (c)(2)(i);

b. Revising the term “annual reports” to read “annual reports to security holders” in paragraph (c)(2)(ii) and (c)(4);

c. Revising the term “annual report” to read “annual report to security holders” in paragraph (c)(2)(ii);

d. Revising the word “mail” to read “send” in paragraph (c)(2)(ii); and

e. Adding paragraphs (d) and (e).

The additions and revisions read as follows:

**§240.14b-2 Obligation of banks, associations and other entities that exercise fiduciary powers in connection with the prompt forwarding of certain communications to beneficial owners.**

\* \* \* \* \*

(b) \* \* \*

(3) Upon receipt of the proxy, other proxy soliciting material, information statement, and/or annual report to security holders from the registrant or other soliciting

person, the bank shall forward such materials to each beneficial owner on whose behalf it holds securities, no later than five business days after the date it receives such material and, where a proxy is solicited, the bank shall forward, with the other proxy soliciting material and/or the annual report to security holders, either:

\* \* \* \* \*

Note to Paragraph (b)(3): At the request of a registrant, or on its own initiative so long as the registrant does not object, a bank may, but is not required to, deliver one annual report to security holders, proxy statement, information statement, or Notice of Internet Availability of Proxy Materials to more than one beneficial owner sharing an address if the requirements set forth in §240.14a-3(e)(1) (with respect to annual reports to security holders, proxy statements, and Notices of Internet Availability of Proxy Materials) and §240.14c-3(c) (with respect to annual reports to security holders, information statements, and Notices of Internet Availability of Proxy Materials) applicable to registrants, with the exception of §240.14a-3(e)(1)(i)(E), are satisfied instead by the bank.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(i) Its obligations under paragraphs (b)(2), (b)(3), (b)(4) and (d) of this section if the registrant or other soliciting person, as applicable, does not provide assurance of reimbursement of its reasonable expenses, both direct and indirect, incurred in connection with performing the obligations imposed by paragraphs (b)(2), (b)(3), (b)(4) and (d) of this section; or

\* \* \* \* \*

(d) Compliance with §240.14a-16. If a registrant or other soliciting person informs the bank that it intends to rely on §240.14a-16 to furnish proxy materials to beneficial owners and provides all of the relevant information listed in §240.14a-16(d) to the bank, the bank shall:

(1) Prepare and send a Notice of Internet Availability of Proxy Materials containing the information required in paragraph (e) of this section to beneficial owners no later than:

(i) With respect to a registrant, 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; and

(ii) With respect to a soliciting person other than the registrant, the later of:

(A) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; or

(B) 10 calendar days after the date that the registrant first sends its proxy statement or Notice of Internet Availability of Proxy Materials to security holders.

(2) Establish a Web site at which beneficial owners are able to access the bank's request for voting instructions and, at the bank's option, establish a Web site at which beneficial owners are able to access the proxy statement and other soliciting materials, provided that such Web sites are maintained in a manner consistent with paragraphs (b), (c), and (k) of §240.14a-16;

(3) Upon receipt of a request from the registrant or other soliciting person, send to security holders specified by the registrant or other soliciting person a copy of the request for voting instructions accompanied by a copy of the intermediary's Notice of Internet Availability of Proxy Materials 10 days or more after the bank sends its Notice of Internet Availability of Proxy Materials pursuant to paragraph (d)(1); and

(4) Upon receipt of a request for a copy of the materials from a beneficial owner:

(i) Request a copy of the soliciting materials from the registrant or other soliciting person, in the form requested by the beneficial owner, within three business days after receiving the beneficial owner's request;

(ii) Forward a copy of the soliciting materials to the beneficial owner, in the form requested by the beneficial owner, within three business days after receiving the materials from the registrant or other soliciting person; and

(iii) Maintain records of security holder requests to receive a paper or e-mail copy of the proxy materials in connection with future proxy solicitations and provide copies of the proxy materials to a security holder who has made such a request for all securities held in the account of that security holder until the security holder revokes such request.

(e) Content of Notice of Internet Availability of Proxy Materials. The bank's Notice of Internet Availability of Proxy Materials shall:

(1) Include all information, as it relates to beneficial owners, required in a registrant's Notice of Internet Availability of Proxy Materials under §240.14a-16(d), provided that the bank shall provide its own, or its agent's, toll-free telephone number,

e-mail address, and Internet Web site to service requests for copies from beneficial owners; and

(2) Otherwise be prepared and sent in a manner consistent with paragraphs (e), (f), and (g) of §240.14a-16.

13. Amend §240.14c-2 by:

- a. Revising paragraph (a); and
- b. Adding paragraph (d).

The revision and addition read as follows:

**§240.14c-2 Distribution of information statement.**

(a)(1) In connection with every annual or other meeting of the holders of the class of securities registered pursuant to section 12 of the Act or of a class of securities issued by an investment company registered under the Investment Company Act of 1940 that has made a public offering of securities, including the taking of corporate action by the written authorization or consent of security holders, the registrant shall transmit to every security holder of the class that is entitled to vote or give an authorization or consent in regard to any matter to be acted upon and from whom proxy authorization or consent is not solicited on behalf of the registrant pursuant to section 14(a) of the Act:

(i) A written information statement containing the information specified in Schedule 14C (§240.14c-101);

(ii) A publicly-filed information statement, in the form and manner described in §240.14c-3(d), containing the information specified in Schedule 14C (§240.14c-101);  
or

(iii) A written information statement included in a registration statement filed under the Securities Act of 1933 on Form S-4 or F-4 (§239.25 or §239.34 of this chapter) or Form N-14 (§239.23 of this chapter) and containing the information specified in such Form.

(2) Notwithstanding paragraph (a)(1) of this section:

(i) In the case of a class of securities in unregistered or bearer form, such statements need to be transmitted only to those security holders whose names are known to the registrant; and

(ii) No such statements need to be transmitted to a security holder if a registrant would be excused from delivery of an annual report to security holders or a proxy statement under §240.14a-3(e)(2) if such section were applicable.

\* \* \* \* \*

(d) A registrant may transmit an information statement to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16; provided, however, that the registrant may revise the information required in the Notice of Internet Availability of Proxy Materials to reflect the fact that the registrant is not soliciting proxies for the meeting. This paragraph (d) provides a non-exclusive alternative by which a registrant may transmit an information statement pursuant to paragraph (a) of this section to a security holder. This paragraph (d) does not affect the availability of any other means by which a registrant may transmit an information statement pursuant to paragraph (a) of this section to a security holder.

14. Amend §240.14c-3 by:

a. Removing the authority citation following this section;

b. Revising paragraphs (a)(1) and (c); and

c. Adding paragraph (d).

The revisions and addition read as follows:

**§240.14c-3 Annual report to be furnished security holders.**

(a) \* \* \*

(1) The annual report to security holders shall contain the information specified in paragraphs (b)(1) through (b)(11) of §240.14a-3.

\* \* \* \* \*

(c) A registrant will be considered to have delivered a Notice of Internet Availability of Proxy Materials, annual report to security holders or information statement to security holders of record who share an address if the requirements set forth in §240.14a-3(e)(1) are satisfied with respect to the Notice of Internet Availability of Proxy Materials, annual report to security holders or information statement, as applicable.

(d) A registrant may furnish an annual report to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16. This paragraph (d) provides a non-exclusive alternative by which a registrant may furnish an annual report pursuant to paragraph (a) of this section to a security holder. This paragraph (d) does not affect the availability of any other means by which a registrant may furnish an annual report pursuant to paragraph (a) of this section to a security holder.

15. Amend §240.14c-5 by revising the word “mailed” to read “sent” in the second sentence of the introductory text of paragraph (a).

16. Amend §240.14c-7 by revising paragraph (a)(5) before the Note and the word “mail” to read “send” in Note 2 following paragraph (a).

The revision reads as follows:

**§240.14c-7 Providing copies of material for certain beneficial owners.**

(a) \* \* \*

(5) Upon the request of any record holder or respondent bank that is supplied with Notices of Internet Availability of Proxy Materials, information statements and/or annual reports to security holders pursuant to paragraph (a)(3) of this section, pay its reasonable expenses for completing the sending of such material to beneficial owners.

\* \* \* \* \*

17. Amend §240.14c-101 by:

- a. Revising the word “mailing” to read “sending” in Item 4, Instruction 1;
- and
- b. Revising Item 5.

The revision reads as follows.

**§240.14c-101 Schedule 14C. Information required in information statement.**

\* \* \* \* \*

Item 5. Delivery of documents to security holders sharing an address. If one annual report to security holders, information statement, or Notice of Internet Availability of Proxy Materials is being delivered to two or more security holders who share an address, furnish the following information in accordance with §240.14a-3(e)(1):

(a) State that only one annual report to security holders, information statement, or Notice of Internet Availability of Proxy Materials, as applicable, is being delivered to multiple security holders sharing an address unless the registrant has received contrary instructions from one or more of the security holders;

(b) Undertake to deliver promptly upon written or oral request a separate copy of the annual report to security holders, information statement, or Notice of Internet Availability of Proxy Materials, as applicable, to a security holder at a shared address to which a single copy of the documents was delivered and provide instructions as to how a security holder can notify the registrant that the security holder wishes to receive a separate copy of an annual report to security holders, information statement, or Notice of Internet Availability of Proxy Materials, as applicable;

(c) Provide the phone number and mailing address to which a security holder can direct a notification to the registrant that the security holder wishes to receive a separate annual report to security holders, information statement, or Notice of Internet Availability of Proxy Materials, as applicable, in the future; and

(d) Provide instructions how security holders sharing an address can request delivery of a single copy of annual reports to security holders, information statements, or Notices of Internet Availability of Proxy Materials if they are receiving multiple copies of annual reports to security holders, information statements, or Notices of Internet Availability of Proxy Materials.

#### **PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934**

18. The general authority citation for Part 249 is revised to read as follows:

Authority: 15 U.S.C. 78a et seq., 7202, 7233, 7241, 7262, 7264, and 7265; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

19. Amend Item 4 to "Part II - Other Information" of Form 10-Q (referenced in §249.308a) by revising paragraph (d) to read as follows:

**Note: The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.**

**Form 10-Q**

\* \* \* \* \*

**Part II - Other Information**

\* \* \* \* \*

**Item 4. Submission of Matters to a Vote of Security Holders.**

\* \* \* \* \*

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

\* \* \* \* \*

20. Amend Item 4 to "Part II - Other Information" of Form 10-QSB (referenced in §249.308b) by revising paragraph (d) to read as follows:

**Note: The text of Form 10-QSB does not, and this amendment will not, appear in the Code of Federal Regulations.**

**Form 10-QSB**

\* \* \* \* \*

**Part II - Other Information**

\* \* \* \* \*

**Item 4. Submission of Matters to a Vote of Security Holders.**

\* \* \* \* \*

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

\* \* \* \* \*

21. Amend Item 4 to Part I of Form 10-K (referenced in §249.310) by revising paragraph (d) to read as follows:

**Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.**

#### **Form 10-K**

\* \* \* \* \*

#### **Part I**

\* \* \* \* \*

#### **Item 4. Submission of Matters to a Vote of Security Holders.**

\* \* \* \* \*

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

\* \* \* \* \*

22. Amend Item 4 to Part I of Form 10-KSB (referenced in §249.310b) by revise paragraph (d) to read as follows:

**Note: The text of Form 10-KSB does not, and this amendment will not, appear in the Code of Federal Regulations.**

**Form 10-KSB**

\* \* \* \* \*

**Part I**

\* \* \* \* \*

**Item 4. Submission of Matters to a Vote of Security Holders.**

\* \* \* \* \*

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

\* \* \* \* \*

**PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940**

23. The authority citation for Part 274 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

\* \* \* \* \*

24. Amend Sub-Item 77C to “Instructions to Specific Items” of Form N-SAR (referenced in §§ 249.330 and 274.101) by revising paragraph (d) to read as follows:

**Note: The text of Form N-SAR does not, and this amendment will not, appear in the Code of Federal Regulations.**

**Form N-SAR**

\* \* \* \* \*

**Instructions to Specific Items**

\* \* \* \* \*

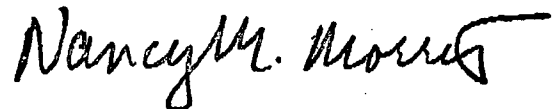
**SUB-ITEM 77C: Submission of matters to a vote of security holders**

\* \* \* \* \*

(d) Describe the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

\* \* \* \* \*

By the Commission.



Nancy M. Morris  
Secretary

January 22, 2007

Commissioner Campos  
Not Participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55150 / January 23, 2007

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2582 / January 23, 2007

INVESTMENT COMPANY ACT OF 1940  
Release No. 27674 / January 23, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12545

In the Matter of

DOUGLAS P. MILLER,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTIONS 15(b), 17A(c)(4)(C) AND 21C OF  
THE SECURITIES EXCHANGE ACT OF  
1934, SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
AND SECTION 9(b) OF THE INVESTMENT  
COMPANY ACT OF 1940

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), 17A(c)(4)(C) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Douglas P. Miller ("Miller" 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

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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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b), 17A(c)(4)(C) and 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act ("Order") as set forth below.

### **III.**

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

#### **Respondent**

1. Miller, age 32, is a resident of Minot, North Dakota. From August 1998 to March 2006, he was the secretary and treasurer of a North Dakota limited liability company that was dually registered with the Commission as a transfer agent and investment adviser (the "Adviser"). From February 1999 to March 2006, Miller was also a registered representative, secretary and treasurer of a North Dakota limited liability company registered with the Commission as a broker-dealer. From February 1999 to March 2006 he was also vice president, secretary and an interested trustee of a Delaware business trust registered with the Commission as an investment company. Contained within the investment company were four mutual funds managed by the Adviser, one of which is relevant to this proceeding (the "Fund").

#### **Background**

2. From April 2005 through February 2006, Miller made unauthorized charges totaling \$19,250 on a credit card owned by the Adviser and wrote checks and otherwise diverted \$27,318 from the Adviser's bank accounts, without the knowledge or permission of the Adviser and for his personal use.

3. On or about November 25, 2005, Miller redeemed the shares in a Fund account totaling \$51,161, without the knowledge or permission of the shareholder who owned the account. Miller then made the redemption check out to himself, forged the required second signature on the check, and deposited the check in his personal checking account.

4. On or about November 30, 2005 Miller used \$49,027 of the misappropriated proceeds from the Fund account to repay the money he had improperly taken from the Adviser.

5. On or about February 22, 2006, after the Adviser became aware of the unauthorized use of the credit card, the misappropriation of bank account funds and the unauthorized redemption of the Fund account, Miller repaid the victimized shareholder in total.

6. As a result of the conduct described above, Miller willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

#### **Disgorgement and Civil Penalties**

7. Respondent has submitted a sworn Statement of Financial Condition dated May 30, 2006 and amended on June 5, 2006 and other evidence and has asserted his inability to pay a civil penalty.

#### **Miller's Remedial Efforts**

8. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

### **IV.**

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

Accordingly, pursuant to Sections 15(b), 17A(c)(4)(C) and 21C of the Exchange Act, Sections 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Miller 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 Miller be, and hereby is, barred from association with any broker, dealer, transfer agent, or investment adviser, 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;

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. Based upon Respondent's sworn representations in his Statement of Financial Condition dated May 30, 2006, as amended on June 5, 2006 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Nancy M. Morris  
Secretary

  
By Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 27673 / January 23, 2007

In the Matter of

DEUTSCHE BANK TRUST COMPANY AMERICAS  
60 Wall Street  
New York, New York 10005

(812-13212)

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940

Deutsche Bank Trust Company Americas filed an application on July 7, 2005 and an amendment to the application on December 21, 2006 requesting an order under Section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from certain requirements of Rule 3a-7(a)(4)(i) under the Act.

The order exempts issuers of asset-backed securities from certain requirements of Rule 3a-7(a)(4)(i) under the Act enabling Deutsche Bank Trust Company Americas to act as trustee to those issuers and permitting the issuers to rely on Rule 3a-7.

On December 28, 2006, a notice of the filing of the application was issued (Investment Company Act Release No. 27644). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemption is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Accordingly, in the matter of Deutsche Bank Trust Company Americas (File No. 812-13212), IT IS ORDERED, under Section 6(c) of the Act, that the requested exemption from certain

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requirements of Rule 3a-7(a)(4)(i) under the Act is granted, effective immediately, subject to the conditions contained in the application, as amended.

By the Commission.

Nancy M. Morris  
Secretary

*Florence E. Harmon*

By: Florence E. Harmon  
Deputy Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

Release No. 55148 / January 23, 2007

**ADMINISTRATIVE PROCEEDING**

File No. 3-12543

**In the Matter of**

**Pacific Growth Equities, LLC,  
Stephen J. Massocca, and  
Robert Katz,**

**Respondents.**

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

**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"), against Pacific Growth Equities, LLC ("PGE"), Stephen J. Massocca ("Massocca") and Robert Katz ("Katz") (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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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### III.

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

#### Summary

1. Since at least April 2002, securities broker-dealer and Nasdaq market maker PGE has engaged in a practice of secretly double-charging certain customers for securities transactions. PGE has historically received compensation for handling customer trades by adding a markup or markdown to the price at which the firm bought (or sold) shares in the market, plus a spread. By early 2002, however, consistent with industry trends, certain PGE institutional customers requested that they be charged commissions for their trades instead of compensating PGE with a markup, markdown or spread. PGE accommodated these requests, but, unbeknownst to certain customers, continued to receive markups or markdowns ("trading profits") in addition to commissions for certain trades. These dual charges were not adequately disclosed to customers, and were inconsistent with the understandings between PGE and its customers.

2. PGE's practice of failing to disclose trading profits was in part facilitated by the use of inaccurate time stamps on certain customer order tickets. Rather than time stamping the ticket at the time the order had originally been received from its customer, PGE time stamped order tickets only after the firm had acquired (or sold) shares in the market to satisfy certain customers' orders. This practice created the appearance that PGE was instantaneously filling customer orders, and thus that the firm was engaged in typical market making transactions in return for a markup or markdown.

3. PGE's Co-Chief Executive Officer, Stephen J. Massocca, authorized PGE's conduct. PGE's head trader, Robert Katz, was responsible for some of the inaccurate time stamps.

4. By virtue of these activities, PGE willfully violated Sections 15(c)(1) and 17(a) of the Exchange Act and Rule 17a-3 thereunder, Massocca willfully aided and abetted and caused PGE's violations of Sections 15(c)(1) and 17(a) of the Exchange Act and Rule 17a-3, and Katz willfully aided and abetted and caused PGE's violation of Exchange Act Section 17(a) and Rule 17a-3.

#### Respondents

5. Pacific Growth Equities, LLC, is a Delaware limited liability company with its principal place of business in San Francisco, California. Since 1989, PGE or its predecessor corporation has been a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act.

6. Stephen J. Massocca, age 47, is a resident of San Francisco, California. Massocca is currently PGE's Co-Chief Executive Officer. From 1991-2004, Massocca served as PGE's Head of Trading. From 2000-2002, Massocca was also PGE's co-compliance officer.

7. Robert Katz, age 43, is a resident of San Francisco, California. Katz currently serves as PGE's Head of Trading. From 1991-2004, Katz was a trader on PGE's trading desk.

### Facts

#### PGE Added Undisclosed Trading Profits On Trades With Certain Customers

8. PGE is a registered broker-dealer that processes securities trades on behalf of an institutional customer base consisting of hedge funds, corporations and other investors. PGE is a Nasdaq market maker in that it is a dealer who, with respect to securities, holds itself out as being willing to buy and sell such securities for its own account on a regular or continuous basis.

9. Historically, Nasdaq market makers acting in a "principal" capacity (buying and selling securities into or out of their own accounts) transacted orders for their customers on a "net" basis. In such "net" transactions, market makers receive compensation for their services through the difference between the price at which the market maker originally purchased the security for its own account and the price at which it sold the security to the customer, rather than from a commission. In contrast, brokers transacting "agency" trades on behalf of their customers – trades where the securities would not pass through the broker's proprietary account – traditionally received compensation for their services by charging per share or basis point (percentage of total transaction price) commissions.

10. Beginning in late 2001, the brokerage industry experienced a shift whereby many market makers no longer executed trades on a "net" basis and instead began to be compensated for their services by charging per share or basis point commissions to customers.

11. Consistent with this change in industry practice, by April 2002, certain PGE customers began requesting that their orders no longer be handled on a "net" basis and that instead they be charged only commissions on their securities trades. PGE agreed to these requests, and the customers understood that they would be charged only commissions for their trades.

12. PGE failed to disclose that PGE would sometimes continue to add a trading profit onto the transaction price in addition to the commission it charged to the customer. In particular, electronic trade confirmations sent by PGE to its institutional customers reported the commission that was being charged for the trade but did not disclose that PGE, at least in some instances, was continuing to add trading profits. PGE's customers were not informed of the additional trading profits, and the charges were contrary to the understanding of the affected PGE customers that they would pay only commissions. A review of selected trading data by the Commission staff identified several hundred thousand dollars in undisclosed charges passed along to PGE's customers during the 2003-2004 time period.

13. As the member of PGE's management team with supervisory responsibility for the trading desk, Massocca was aware that PGE's practice of adding a profit in addition to a commission for certain transactions was contrary to what customers understood to be PGE's compensation for order execution. Massocca was informed that certain customers had requested riskless principal trades and that they did not understand that they were paying both a

commission and a markup or markdown. Massocca nevertheless permitted PGE's practice of double-charging customers without adequate disclosure to continue.

#### PGE's Use of Inaccurate Time Stamps

14. PGE's practices were in part facilitated through improper time stamping procedures, which created a misleading record of when customer orders were received and the risk PGE ostensibly incurred in filling the orders.

15. Brokers typically time-stamp customer order tickets as soon as the order is placed by the customer and the broker's representative understands the terms of the order. In contrast, PGE's traders delayed time-stamping certain order tickets. Instead, the traders would first go into the interdealer market and buy or sell the stock needed to fill the customer's order. Only then would the trader time stamp the order ticket to show the time that the customer's order was received.

16. Because PGE went into the interdealer market to fill a customer order before stamping the customer's order ticket with the time of receipt, PGE's trading records appeared to show that PGE had instantly filled the customer order out of its own trading inventory. The delayed time-stamping tended to show that PGE had risked its capital as a market maker, when it actually had handled the trade as a "riskless principal," purchasing or selling shares only in response to a specific customer order and receiving a commission for its services.

17. By maintaining inaccurate records of the time at which orders were received, PGE could make it appear that it had already accumulated an inventory in the stock as a result of its market making transactions and then later filled customer orders from that inventory in return for a markup or markdown.

18. As both a trader and later Head of Trading for PGE, Katz time-stamped or authorized the stamping of some order tickets with inaccurate time stamps. As the member of PGE's management team with supervisory responsibility for the trading desk, Massocca was aware of and authorized the inaccurate time stamps.

#### Violations

19. As a result of the conduct described above, PGE willfully violated Section 15(c)(1) of the Exchange Act thereunder, in that it, while acting as a broker or dealer, effectuated securities transactions by means of a manipulative, deceptive or other fraudulent device or contrivance. Massocca willfully aided and abetted and caused PGE to violate Section 15(c)(1) of the Exchange Act.

20. As a result of the conduct described above, PGE willfully violated Section 17(a) and Rule 17a-3 of the Exchange Act, in that it, while acting as a broker or dealer, failed to make and keep current books and records relating to its business. Massocca and Katz willfully aided and abetted and caused PGE to violate Section 17(a) and Rule 17a-3 of the Exchange Act.

### Undertakings

21. In determining whether to accept the Offer, the Commission considered the following remedial acts voluntarily undertaken by PGE:

A. In 2005, PGE purchased and implemented an automated order management system to process Nasdaq transactions and capture accurately the time stamps and other data required by Rule 17a-3.

B. PGE agrees to retain, at its own expense, the services of a qualified independent consultant ("Consultant") not unacceptable to the staff to review PGE's electronic order management system and order tickets on an annual basis for two years following the date of the Commission's Order. PGE will require the Consultant to ensure: (i) that PGE has provided an adequate disclosure to its institutional customers about the capacity in which it executes trades and whether or not PGE may make a trading profit or loss in its own account in addition to charging a per share or basis point commission; and (ii) that PGE's electronic order tickets contain all information required by Rules 17a-3(a)(6)-(7). PGE will require the Consultant to prepare a report of his or her findings and recommendations and forward the report to both PGE and to the Associate District Administrator for Enforcement (the "Associate Administrator") in the Commission's San Francisco District Office. PGE undertakes to be bound by the Consultant's recommendations. PGE may suggest alternative procedures to achieve the goals of the recommendations, however, after notice to the Consultant and the Associate Administrator. PGE will require the 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 Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with PGE, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the 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 Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Associate Administrator, enter into any employment, consultant, attorney-client, auditing or other professional relationship with PGE, 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.

### 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 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent PGE shall cease and desist from committing or causing any violations and any future violations of Section 15(c)(1) and 17(a) of the Exchange Act and Rule 17a-3 thereunder;

B. Respondent Massocca shall cease and desist from causing any violations and any future violations of Sections 15(c)(1) and 17(a) of the Exchange Act and Rule 17a-3 thereunder;


C. Respondent Katz shall cease and desist from causing any violations and any future violations of Section 17(a) and Rule 17a-3 of the Exchange Act;

D. Respondents PGE, Massocca and Katz are hereby censured;

E. PGE, Massocca and Katz shall, within 20 days of the entry of this Order, pay civil money penalties to the United States Treasury in the following amounts: PGE: \$425,000; Massocca: \$75,000; and Katz: \$20,000. Such payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under a cover letter that identifies Pacific Growth Equities, LLC, Stephen J. Massocca and Robert Katz as the Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helane L. Morrison, District Administrator, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104;

F. Respondent PGE shall comply with the undertakings enumerated in Section III.21.B. above.

By the Commission.

  
Nancy M. Morris  
Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

CORRECTED

**SECURITIES ACT OF 1933**  
**Release No. 8775 / January 23, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12543**

**In the Matter of**

**Pacific Growth Equities, LLC**

**Respondent.**

**ORDER UNDER RULE 602(e) OF  
THE SECURITIES ACT OF 1933  
GRANTING A WAIVER OF THE  
DISQUALIFICATION PROVISION OF  
RULE 602(c)(3)**

Pacific Growth Equities, LLC ("Respondent") has submitted a letter, dated December 6, 2006, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption under Regulation E under the Securities Act of 1933 ("Securities Act") arising from the settlement of a cease-and-desist and administrative proceeding commenced by the Commission. On January 23, 2007, pursuant to the Respondent's Offer of Settlement, the Commission instituted an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) and 21C of the Securities Exchange Act of 1934 ("OIP") against Respondent.

The OIP censures Respondent and finds that by engaging in a course of business where it double-charged certain customers for securities transactions, Respondent violated Sections 15(c)(1) and 17(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 17a-3 thereunder. In addition, the OIP requires Respondent to cease and desist from committing or causing violations and future violations of the preceding provisions, to pay a civil penalty of \$425,000, and to comply with certain undertakings.

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for securities issued by certain small business investment companies and business development companies. The Regulation E exemption is not available for the securities of an issuer if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 15(b) of the

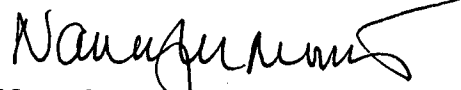
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Exchange Act. *See* Rule 602(c)(3) under the Securities Act. The Commission may waive the disqualification upon a showing of good cause. *See* Rule 602(e) under the Securities Act.

Based on the representations set forth in Respondent's December 6, 2006 request, the Commission has determined that, pursuant to Rule 602(e), a showing of good cause has been made and that the request for a waiver of the disqualification should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of the OIP is hereby granted.

By the Commission.



Nancy M. Morris  
Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55149 / January 23, 2007**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 2545 / January 23, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12544**

**In the Matter of**

**SUZANNE BROWN, CPA**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO RULE 102(e)  
OF THE COMMISSION'S RULES OF  
PRACTICE, 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 against Suzanne Brown, CPA ("Respondent" or "Brown") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

**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 her and the subject matter of these proceedings, and the findings contained in Section III.4 below, which are admitted, Respondent

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<sup>1</sup> 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, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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. Suzanne Brown, age 40, is and has been a certified public accountant licensed to practice in the State of Pennsylvania. She served as Corporate Controller of U.S. Foodservice, Inc. ("USF") in its Columbia, Maryland headquarters. Brown joined USF in July 1998, and served as an Assistant Controller until her promotion to Controller in late 2001.

2. Royal Ahold (Koninklijke Ahold N.V.) ("Ahold") is a publicly-held company organized in the Netherlands with securities registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"). Ahold's common stock trades in the United States on the New York Stock Exchange under the symbol AHO as evidenced by American Depositary Receipts.

3. USF, a foodservice and distribution company with headquarters in Columbia, Maryland, is a wholly-owned subsidiary of Ahold.

4. On January 11, 2007, a final judgment was entered against Brown, permanently enjoining her from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13b2-2 thereunder, in the civil action entitled Securities and Exchange Commission v. Suzanne Brown, Civil Action Number 07-0038, in the United States District Court for the District of Columbia. Brown was also ordered to pay a \$100,000 civil penalty.

5. The Commission's complaint alleged, among other things, that Brown and executives of USF engaged in a large-scale fraud that, for fiscal years 2001 and 2002, materially overstated income by approximately \$700 million in Commission filings and other public announcements. The Complaint further alleged that Brown, in conjunction with USF executives, made or directed others to make entries, including releases of reserves and accruals, in USF's books and records that she knew, or was reckless in not knowing, were false, without basis in fact, and did not comply with Generally Accepted Accounting Principles. The Complaint also alleged that Brown, in conjunction with USF executives, provided Ahold's independent auditors with false and/or misleading information in connection with their reviews and audit of USF's financial statements.

#### IV.

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

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

A. Brown is suspended from appearing or practicing before the Commission as an accountant.

B. After five (5) years from the date of this Order, Respondent may request that the Commission consider her 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 her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she 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 she is associated, is registered with the Public Company Accounting 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 she 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; and

(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 her 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.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is current and she 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.

By the Commission.

Nancy M. Morris  
Secretary

*Jill M. Peterson*  
By **Jill M. Peterson**  
**Assistant Secretary**

**UNITED STATES OF AMERICA**  
Before the  
**SECURITIES AND EXCHANGE COMMISSION**  
January 24, 2007

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12549**

**In the Matter of**

**Tempo Securities Corporation**  
**Robert Shiffra**  
**Dennis Zauszniewski**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**I.**

The Securities and Exchange Commission ("Commission" or "SEC") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 ("Exchange Act") against Tempo Securities Corporation, and pursuant to Section 15(b)(6) of the Exchange Act against Robert Shiffra and Dennis Zauszniewski (collectively, "Respondents").

**II.**

After an investigation, the Division of Enforcement alleges:

**Respondents**

1. Tempo Securities Corporation ("Tempo"), a broker-dealer registered with the Commission since 1986, is a member of the National Association of Securities Dealers ("NASD"). Tempo conducts a general securities business in over-the-counter and listed securities. Tempo is headquartered in Cleveland, Ohio. From in or about 1995 to in or about 2004, Tempo had up to twenty registered representatives who operated off-site one-person offices.
2. Robert Shiffra ("Shiffra"), age 73, is the president of Tempo and owns two thirds of the company. Shiffra has been an owner and officer of Tempo since 1991. Shiffra has been a licensed but nonpracticing attorney since 1966 and also occasionally serves as an arbitrator in the securities industry, including for the NASD. Shiffra has been working in the securities industry for at least 40 years and has held his Series 24 license since 1978. Shiffra was previously the head

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of the compliance department for a broker-dealer, where he wrote the firm's compliance and procedures manual.

3. Dennis Zauszniewski ("Zauszniewski"), age 55, is a founder and the senior vice president of Tempo. Zauszniewski owns one third of the company, has been an owner and officer of Tempo since 1986, and has held his Series 24 license since 1986. Zauszniewski occasionally serves as an arbitrator in the securities industry.

#### **Related Party**

4. Gregory A. Applegate ("Applegate"), age 46, is currently serving a five-year prison term at the Federal Correctional Institute in Morgantown, West Virginia. Applegate was a registered representative associated with Tempo Securities from approximately April 1995 until approximately the end of December 2004, operating out of an office in Ashland, Ohio.

#### **Summary**

5. From in or about 2001 through approximately the end of 2004, while employed by and associated with Tempo as a registered representative, Applegate made misrepresentations of material facts to over 110 investors and defrauded them regarding the investment of at least \$3.1 million in what they were told to be securities. Throughout this time, Respondents supervised Applegate. Respondents, however, failed reasonably to supervise Applegate with a view to preventing and/or detecting his fraudulent conduct. Respondents failed to establish reasonable supervisory procedures for conducting on-site inspections and reviewing DBA accounts, and they failed to establish a reasonable system to effectively implement supervisory procedures that did exist for review of customer communications and review of customer account statements. Finally, Shiffra and Zauszniewski failed reasonably to respond to serious "red flags" indicating possible misconduct by Applegate.

#### **Applegate Came to Tempo Amid Allegations of Fraud**

6. Applegate joined Tempo in 1995. Approximately two years later, customers at Applegate's former brokerage firm filed an NASD arbitration claim against Applegate and his former firm, alleging that Applegate had committed fraud and breach of fiduciary duty, causing damages of approximately \$140,000. Applegate was accused of providing his customers fraudulent account statements that concealed his excessive trading activity on their accounts. This alleged fraudulent conduct took place just before Applegate left for Tempo.

7. Respondents were aware of the substance of these allegations soon after the claim was filed. During investigative testimony before the staff of the Division of Enforcement, Shiffra claimed that he did not remember Applegate's explanation regarding the allegations, but Shiffra testified that he "didn't buy it when [he] heard it." At no time did Respondents attempt to contact Applegate's former supervisor or the complaining customers regarding the allegations.

8. During investigative testimony before the staff of the Division of Enforcement, Shiffra admitted that the timing of this alleged fraud and Applegate's move to Tempo "would raise

concern. All of these things would be flags . . . it looks like that would be a reason he'd be leaving: under the scrutiny of Ohio Company checking with his customer."

### **Applegate's Ponzi Scheme**

9. From in or about 2001 through the end of August 2005, Applegate solicited at least 160 investors to invest at least \$9.5 million in a supposed "hedge fund" and other investment vehicles, purportedly through an entity called "Applegate Investments" and other similar names. Applegate orally guaranteed an annual rate of return to these investors. In reality, "Applegate Investments" was a Ponzi scheme: Applegate misappropriated investor funds, using them to finance an unrelated personal business, pay personal expenses, and pay "investment returns" to earlier investors. To carry out this scheme, Applegate mailed to investors false monthly "customer statements" maintained on his office computer, reflecting securities holdings and returns that did not exist, as well as monthly "dividend checks."

10. Throughout the period from in or about 2001 through approximately the end of 2004, Applegate was associated with Tempo as a registered representative.

11. While Applegate was associated with Tempo, at least 50% of "Applegate Investments" Ponzi scheme investors were also Tempo customers, and at least 40% of Applegate's Tempo customers with equity accounts also invested in the "Applegate Investments" Ponzi scheme.

12. Applegate continued operating the "Applegate Investments" Ponzi scheme after leaving Tempo at the end of 2004 for another brokerage firm. In August 2005, Applegate's supervisor at his new firm learned that one of Applegate's customers had received possibly false account statements directly from Applegate. Applegate's supervisor immediately conducted an unannounced review of Applegate's office in Ashland and discovered evidence of the "Applegate Investments" Ponzi scheme in Applegate's customer files. These customers had also been Tempo customers when Applegate was with Tempo.

13. Applegate's misconduct described above violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

14. On October 7, 2005, the Commission filed a complaint in SEC v. Gregory Applegate, No. 1:05CV2363, in the Northern District of Ohio, and obtained a temporary restraining order against Applegate, including an asset freeze. The complaint alleged the facts referred to in paragraph 6 above, and sought injunctive as well as monetary relief against Applegate.

15. On January 9, 2006, in the case of U.S. v. Gregory A. Applegate, No. 1:05-cr-00577-PAG in the Northern District of Ohio, Applegate plead guilty to a one count information charging mail fraud, in violation of Title 18, U.S. Code, Section 1341, for conduct related to the "Applegate Investments" Ponzi scheme.

16. During the plea colloquy in the criminal case referred to in the previous paragraph, Applegate admitted that as early as 2001 and continuing until September 2005, he "executed a scheme and artifice to defraud certain clients of his and to obtain money by means of fraudulent

pretenses, representations and promises.” Applegate also admitted that “in order to conceal this fraudulent scheme . . . [he] caused statements to be mailed to his clients, usually on a monthly or quarterly basis, from his office in Ashland, which falsely reflected the nature of his clients’ investments and the balances in his clients’ accounts.”

17. On April 26, 2006, Applegate was sentenced to 5 years in prison and was ordered to pay approximately \$2.9 million in restitution to aggrieved investors of the “Applegate Investments” Ponzi scheme.

18. On October 17, 2006, in SEC v. Gregory Applegate, the District Court entered a final judgment against Applegate including the entry of an order of permanent injunction enjoining him from violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

19. On October 30, 2006, the SEC instituted settled Administrative Proceedings against Applegate, barring him from association with any broker or dealer.

**Respondents held all supervisory authority at Tempo**

20. Tempo, Shiffra, and Zauszniewski supervised Applegate while he was associated with Tempo as a registered representative, from approximately April 1996 to approximately the end of 2004.

21. Shiffra and Zauszniewski jointly made all decisions regarding establishing Tempo’s supervisory and compliance procedures and were jointly responsible for implementing and enforcing existing procedures. Shiffra and Zauszniewski jointly held all supervisory authority at Tempo, including the ability to discipline, hire and fire registered representatives.

22. Shiffra was Applegate’s designated supervisor at Tempo, and Shiffra performed all on-site visits of Applegate’s office and reviews of Applegate’s operations.

**Respondents failed to establish reasonable supervisory procedures  
or a system to implement existing procedures**

23. During investigative testimony before the staff of the Division of Enforcement, Zauszniewski stated that Tempo is “not a real brokerage firm” and that Tempo does not follow compliance procedures that “real firms” use because they would be “cost [prohibitive].”

24. At all relevant times, Tempo registered representatives have been characterized by Tempo as “independent contractors,” operating out of their own offices or homes without on-site supervision.

25. Applegate operated a one-person branch office in Ashland, Ohio, over an hour’s drive from Tempo’s main office. Tempo thus did not provide on-site supervision for Applegate.

## **Annual Reviews**

26. Respondents did not establish reasonable procedures for inspections of registered representatives' offices, or implement the procedures for inspections of registered representatives' offices that did exist.
27. Respondents conducted only pre-announced scheduled "annual reviews" of its registered representatives' offices and operations. Respondents never conducted any unannounced visits or inspections.
28. During investigative testimony before the staff of the Division of Enforcement, Zauszniewski admitted that, because Respondents' reviews were always announced, Applegate "could have hid a lot of stuff, which he obviously did and intentionally hid."
29. Respondents' on-site visits to Applegate's office did not include reasonable inspection or review of his operations or offices.
30. During all reviews of Applegate's office and operations, Shiffra did not request to review Applegate's account records or customer account files.
31. Besides looking at the top of Applegate's desk and what was visible on his computer screen, Shiffra never conducted any physical inspection of Applegate's office.
32. From approximately 2001 until the end of 2004, Applegate maintained his "Applegate Investments" Ponzi scheme records on his office computer and in a binder labeled "Applegate Investments Accounts" in his office in Ashland, Ohio. At any given time, at least one month's worth of fraudulent customer statements, one for every "Applegate Investments" investor, was maintained in that binder.
33. The binder referenced in the previous paragraph and its label, "Applegate Investments Accounts," were clearly visible during all compliance reviews conducted by Shiffra. Shiffra never inquired about the binder's contents or attempted to inspect the binder.
34. During investigative testimony before the staff of the Division of Enforcement, Shiffra testified that he doubted that he had "the authority to check [Applegate's] computer or file cabinets or desk drawers" as part of a compliance review of Applegate's office. In fact, as Applegate's supervisor, Shiffra had the authority to do so as part of a compliance review.
35. As part of Respondents' annual review of Applegate's office, a survey was mailed to him asking for responses to various compliance questions. No attempt was made to verify Applegate's answers to the annual survey.
36. During investigative testimony before the staff of the Division of Enforcement, Shiffra stated, "I never understood what [Applegate's assistants] did . . . I don't know what kept her busy full-time, especially with his production."

37. Respondents did not ask Applegate, or his administrative assistants, what work the assistants were performing in Applegate's office. Respondents did not attempt to interview Applegate's administrative assistants about any compliance matters. Respondents did not monitor how many administrative assistants Applegate retained.

38. Applegate's administrative assistants helped Applegate create and update the "Applegate Investments" Ponzi scheme customer statements every month, as well as to help mail them to customers. They also helped organize the customer files, including keeping "Applegate Investments" files separate from the legitimate Tempo customer account files.

39. Despite Tempo's own requirements to conduct on-site reviews at least annually, Respondents failed to implement this procedure by failing to conduct an on-site review of Applegate's office during at least one year: 2004; Applegate's last year associated with Tempo.

40. Zauszniewski admitted to examiners from the Commission's Office of Compliance, Inspections, and Examinations that Respondents did not conduct an on-site review of Applegate's office in 2004, citing "personal issues."

#### **Lack of Procedures for Review of Applegate's DBA Bank Accounts**

41. As an "independent contractor," Applegate was responsible for his own business expenses, such as office rent, phone, and electricity.

42. Respondents did not establish procedures to review or inspect, nor did they ever review or inspect, Applegate's business "DBA" bank accounts from which he paid his business expenses.

43. Had Respondents ever asked to review or audit Applegate's "DBA" bank accounts during approximately 2001 through the end of 2004, they would have discovered personal checks from Applegate's Tempo customers being deposited into his "DBA" bank accounts, and funds being diverted from those accounts to his personal bank accounts, as part of the "Applegate Investments" Ponzi scheme.

44. One of Applegate's "DBA" bank accounts was in the name of "Applegate Investments."

#### **Inadequate Implementation of Procedures for Review of Customer Communications**

45. The Tempo Compliance and Procedure Manual required that branch supervisors "devise and institute a program whereby all communication from the public to any registered representative under his authority or control is reviewed daily prior to such material being given to the registered representative." The Tempo Manual also required that branch supervisors "institute and supervise a system whereby the registered representative's communications to the public concerning securities transactions for the business of this organization are reviewed and a copy retained in the branch office filed and a copy sent to the Compliance Director."

46. During investigative testimony before the staff of the Division of Enforcement, Shiffra stated that the requirements in the previous paragraph are "referring to a real branch where all of the incoming mail is opened by one person or supervisor and read and looked at before it's passed out. Where you've got one guy in an office, it doesn't work." Instead, for one-person offices with no on-site supervision such as Applegate's, registered representatives were simply asked to forward copies of all customer correspondence to Respondents. However, no systems were established to effectively implement this requirement.

#### **Lack of Systems to Implement Procedures for Customer Account Statement Review**

47. Tempo's Compliance and Procedure Manual requires that supervisors "review all monthly statements at least four times per year and initial as evidence of such review." Tempo's clearing firm produced monthly account statements for Tempo's customers, and copies of these statements were mailed to Tempo every month. The Tempo Manual also requires that supervisors of branch offices "review monthly the customer statements" to check for unusual activity, excessive commissions, and unusual patterns of buying or selling.

48. Starting some time in 2000, Tempo's clearing firm stopped providing paper copies of the monthly statements, instead providing only electronic copies of customers' monthly account statements on its web site, to which Tempo had access. Tempo had dial-up internet access at its main office.

49. After the clearing firm stopped providing paper copies of the monthly statements some time in 2000 until at least January 2006, Respondents failed to develop a reasonable system to implement procedures regarding review of customer account statements. No one at Tempo reviewed customers' monthly account statements, despite having access to them through the clearing firm's web site.

#### **Shiffra and Zauszniewski failed reasonably to respond to red flags concerning Applegate**

##### **Applegate's Commission Decline**

50. Between 1995 and 2004, Applegate generally was one of Tempo's highest "producers" in terms of commission, at times generating approximately one third of Tempo's total revenue and well over \$100,000 in annual gross commissions.

51. Applegate's annual gross commissions then dropped nearly in half between July 1, 2002 and June 30, 2003, Tempo's fiscal year. Shiffra and Zauszniewski did not investigate this dramatic drop in commissions or ask Applegate why his production had declined.

52. During the same period that Applegate's gross commissions dropped nearly in half, customer investments in the "Applegate Investments" Ponzi scheme more than doubled.

### **Applegate's Repeated Violation of Tempo Advertisement Policy**

53. Applegate repeatedly violated Tempo's advertisement policy when he listed his office in the local Yellow pages as "Applegate Investments" and other variations of that name, instead of "Tempo Securities." Shiffra and Zauszniewski repeatedly told Applegate that this listing was unacceptable, but the listing remained the same for the next nine years without any follow-up, further investigation, or disciplinary action taken against Applegate.

54. Shiffra and Zauszniewski failed reasonably to enforce Tempo's advertisement policy when they failed to follow up or take any action against Applegate for the recurring violation described in the previous paragraph.

55. In addition, Applegate's repeated violation of this Tempo policy was a red flag of suspicious conduct, which Shiffra and Zauszniewski should have investigated.

### **Significant Customer Liquidations**

56. Shiffra and Zauszniewski were aware of numerous liquidations by Applegate's customers from their Tempo securities accounts.

57. Shiffra and Zauszniewski never attempted to contact any of these customers regarding liquidations.

58. With respect to certain significant liquidations, Shiffra testified that he asked Applegate, not the customer, why the customer decided to liquidate their holdings.

59. At least \$900,000 worth of customer liquidations in 2003 and 2004 were deposited in the "Applegate Investments" Ponzi scheme soon thereafter.

60. One of Applegate's Tempo customers liquidated at least \$400,000 worth of securities held with Tempo within an eight-month period. This customer countersigned all of her liquidation checks directly over to Applegate.

### **Applegate Claimed No Correspondence with Customers**

61. During annual reviews, Shiffra asked Applegate for copies of all correspondence with customers.

62. During investigative testimony before the staff of the Division of Enforcement, Shiffra testified that Applegate always told him that he had engaged in no written correspondence with his customers, except for brief notes referring the customers to newspaper articles.

63. Shiffra and Zauszniewski never attempted to verify Applegate's repeated claims that he never engaged in any substantive customer correspondence. For example, Shiffra and

Zauszniewski never communicated with customers to verify that Applegate never corresponded with them.

64. Applegate engaged in regular written correspondence with a large proportion of his Tempo customers: he mailed them monthly account statements regarding their "Applegate Investments" Ponzi scheme investments.

65. Shiffra and Zauszniewski took no independent steps to communicate with Applegate's customers, such as periodic "happiness letters," "activity letters" or any other regular attempts to ascertain customer satisfaction or familiarity with their accounts.

#### **Applegate's Fraud Violations**

66. By virtue of the conduct alleged above, Applegate violated Sections 17(a) of the Securities Act and 10(b) of the Exchange Act and Rule 10b-5 thereunder when he made intentional misrepresentations regarding the investment activity of "Applegate Investments."

67. Applegate represented to some customers that their investments would be pooled into a "hedge fund" invested in various securities. Other investors were told that they were investing directly into mutual funds or municipal funds.

68. In reality, Applegate misappropriated investor deposits, using customers' funds to pay off previous investors and for various personal expenses.

69. Applegate also created false "Applegate Investments" monthly statements to support his misrepresentations as to the status of customers' investments.

#### **Respondents' Failure Reasonably to Supervise Applegate**

70. Section 15(b)(4)(E) of the Exchange Act provides that the Commission can impose various sanctions against a broker-dealer, if it "has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision." Section 15(b)(6)(A)(i) of the Exchange Act similarly provides that the Commission can impose various sanctions against individuals who fail to supervise others who are subject to their supervision, within the meaning of Section 15(b)(4)(E).

71. By virtue of the conduct alleged above, Tempo, Shiffra, and Zauszniewski failed reasonably to supervise Applegate within the meaning of Section 15(b) of the Exchange Act when they failed to supervise Applegate with a view to preventing and detecting violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

72. Respondents failed to establish reasonable supervisory procedures or a system to implement the procedures that did exist. In addition, while Applegate was associated with Tempo, several incidents occurred that should have raised red flags concerning Applegate's

conduct. Shiffra and Zauszniewski, however, did not reasonably respond to these red flags. If Respondents had developed reasonable supervisory procedures for conducting on-site inspections and reviewing DBA accounts, or reasonable systems to implement supervisory procedures for reviewing customer communications and customer account statements, or if Shiffra and Zauszniewski had responded reasonably to red flags, it is likely that they could have prevented and detected Applegate's fraud.

### 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 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 Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B 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 Respondents, and each of them, 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 any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him or 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 each 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, 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.

Nancy M. Morris  
Secretary

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

*Commissioner Casey  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2584 / January 24, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12547

In the Matter of

**BRET GREBOW,**

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 Bret Grebow ("Respondent" or "Grebow").

**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. Grebow was co-founder of, and the sole trader for, HMC International, LLC ("HMC" or the "Fund"), a hedge fund that purportedly invested in stocks traded on the NASDAQ and NYSE using a day trading strategy. Grebow was an investment adviser to HMC in that, for compensation, he engaged in the business of advising HMC as to the advisability of investing in, purchasing, or selling securities. Grebow, 29 years old, resides in Highland Beach, Florida.
2. On January 18, 2007, a final judgment was entered by consent against Grebow, permanently enjoining him from future violations of Section 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) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. HMC International, LLC, et al., Civil Action Number 05-CV-10673 (DC), in the United States District Court for the Southern District of New York.
3. The Commission's complaint alleged that, as sole trader for HMC, Grebow misrepresented the Fund's strategy and performance, and omitted to disclose that for most of the period the Fund was operating its principal was not invested for the benefit of investors. The Commission's complaint also alleges that Grebow misused and misappropriated assets of the Fund, prepared false account statements indicating that investors' funds were earning positive returns, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Grebow be, and hereby is barred from association with any investment adviser.

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.

Nancy M. Morris  
Secretary

*Jim M. Peterson*  
By: **Jim M. Peterson**  
**Assistant Secretary**

Commissioner Casey  
Not participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2583 / January 24, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12546

In the Matter of

ROBERT M. MASSIMI,

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 Robert M. Massimi ("Respondent" or "Massimi").

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. Massimi was co-founder and Chief Executive Officer of HMC International, LLC ("HMC" or the "Fund"), a hedge fund that purportedly invested in stocks traded on the NASDAQ and NYSE using a day trading strategy. Massimi was an investment adviser to HMC in that, for compensation, he engaged in the business of advising HMC as to the advisability of investing in, purchasing, or selling securities. Massimi, 46 years old, resides in Saddle River, New Jersey.

2. On January 18, 2007, a final judgment was entered by consent against Massimi, permanently enjoining him from future violations of Section 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) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. HMC International, LLC, et al., Civil Action Number 05-CV-10673 (DC), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that, as CEO of HMC, Massimi misrepresented the Fund's strategy, risk level and performance, as well as his supervision of and role in managing the Fund. The Commission's complaint also alleged that Massimi misused and misappropriated assets of the Fund, sent out false account statements indicating that investors' funds were earning positive returns, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Massimi be, and hereby is barred from association with any investment adviser.

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.

Nancy M. Morris  
Secretary

  
By **Jill M. Peterson**  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2585 / January 24, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12548

In the Matter of

JOSEPH J. SPIEGEL,

Respondent.

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:  
: 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 Joseph J. Spiegel ("Spiegel" 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. Spiegel is a former portfolio manager for Spinner Asset Management LLC ("Spinner Asset Management"), an investment adviser that registered with the Commission on or about February 6, 2006. Spinner Asset Management serves as the investment adviser for the Spinner Global Technology Fund, Ltd. ("SGTF" or "Fund"), a \$200 million hedge fund. Spiegel is 35 years old and resides in New York, New York.

2. On January 5, 2007, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Section 5 of the Securities Act of 1933 ("Securities Act") in a civil action entitled Securities and Exchange Commission v. Joseph J. Spiegel, Civil Action Number 1:07CV00008, in the United States District Court for the District of Columbia (the "Civil Action").

3. The Commission's complaint alleged that, during 2002, Spiegel, acting through Spinner Asset Management, engaged in an unlawful trading scheme on SGTF's behalf in violation of the antifraud and registration provisions of the federal securities laws in connection with three unregistered securities offerings, which are commonly referred to as "PIPEs" (Private Investment in Public Equity). Spiegel's illegal trading resulted in ill-gotten gains for the Fund.

4. The complaint also alleged that, after agreeing, on behalf of SGTF, to invest in the three PIPE transactions, Spiegel sold short the PIPE issuer's stock through "naked" short sales in Canada. Later, once the Commission declared the resale registration statement effective, Spiegel used SGTF's PIPE shares to close out some or all of the pre-effective date short positions — a practice Spiegel knew or was reckless in not knowing was prohibited by the registration provisions of the federal securities laws. In connection with each of the three PIPEs, to avoid detection and regulatory scrutiny, Spiegel employed wash sales and matched orders to make it appear that he was covering SGTF's pre-effective date short positions with open market stock purchases when in fact the covering transactions were not done with open market shares because SGTF was on both sides of the trades and covered the short positions with its PIPE shares.

5. The complaint further alleged that the unlawful PIPE investment strategy and trading scheme involved three issuers that sought PIPE financing (collectively, "the PIPE Issuers"). During the relevant period, the common stock of each PIPE Issuer was registered with the Commission pursuant to either Section 12(b) or Section 12(g) of the Exchange Act and either was quoted on NASDAQ or traded on the New York Stock Exchange.

6. The complaint also alleged that, in each of the transactions, Spiegel, on behalf of SGTF, also made materially false representations to the PIPE Issuers to induce them to sell securities to the Fund. As a precondition of participation in a PIPE, SGTF had to represent that it

would not sell, transfer or dispose of the PIPE shares other than in compliance with the registration provisions of the Securities Act. This representation was material to the PIPE Issuers, who, as the stock purchase agreements made clear, relied on the investors' representations in order to qualify for an exemption from the registration requirements for their private offering. At the time Spiegel, on behalf of SGTF, signed the securities purchase agreements, however, he intended to distribute the restricted PIPE securities in violation of the registration provisions of the Securities Act.

#### IV.

On the basis 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 203(f) of the Advisers Act, that Respondent be and hereby is barred from association with any investment adviser with the right to reapply for association after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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.

Nancy M. Morris  
Secretary

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

# SECURITIES AND EXCHANGE COMMISSION

## 17 CFR PART 242

[Release No. 34-55160; File No. S7-10-04]

### Regulation NMS

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule; extension of compliance dates.

**SUMMARY:** The Commission is extending for a limited period of time three of the future compliance dates for Rule 610 and Rule 611 of Regulation NMS ("Rule 610" and "Rule 611," respectively) under the Securities Exchange Act of 1934 ("Exchange Act"). Rule 610 requires fair and non-discriminatory access to quotations, establishes a limit on access fees, and requires each national securities exchange and national securities association to adopt, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross protected quotations. Rule 611 requires trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception. The Commission is extending the three compliance dates to give automated trading centers additional time to complete the rollout of their new or modified trading systems.

**DATES:** The effective date for Rule 610 and Rule 611 remains August 29, 2005. Three compliance dates for different functional stages of compliance with Rule 610 and Rule 611 have been extended as set forth in section I of this release, beginning with the "Trading Phase Date," as defined in section I of this release, which has been extended from February 5, 2007 to

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March 5, 2007. The effective date for this release is [insert date of publication in Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Raymond Lombardo, Special Counsel, at (202) 551-5615, or David Liu, Special Counsel, at (202) 551-5645, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

**SUPPLEMENTARY INFORMATION:**

**I. Discussion**

In June 2005, the Commission published its release adopting Regulation NMS.<sup>1</sup> The adopted regulatory requirements include: (1) new Rule 610, which addresses access to markets and locking or crossing quotations; (2) new Rule 611, which provides intermarket protection against trade-throughs (*i.e.*, trades at inferior prices) for certain displayed quotations that are automated and accessible; and (3) an amendment to the joint industry plans for disseminating market information to the public that modifies the formulas for allocating plan revenues to the self-regulatory organization ("SRO") participants in the plans ("Allocation Amendment").

Given the new regulatory framework created by Regulation NMS and the desire of investors and other market participants for more automated and efficient trading services, many SROs have announced major revisions of their trading systems. The SROs and other securities industry participants have been working to comply with the new NMS regulatory requirements. In May 2006, the Commission extended the original compliance dates for Rules 611 and 610 to a series of five dates for phased-in compliance that incorporated the major functional steps

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<sup>1</sup> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("NMS Release").

required to achieve full implementation of Regulation NMS.<sup>2</sup> The extended dates were as follows:

October 16, 2006 ("Specifications Date"): Final date for publication on Internet Web sites of applicable SROs (i.e., the exchange for SRO trading facilities and the NASD for ADF participants) of final technical specifications for interaction with Regulation NMS-compliant trading systems of all automated trading centers (both SRO trading facilities and ADF participants) that intend to qualify their quotations for trade-through protection under Rule 611 during the Pilots Stocks Phase and All Stocks Phase (as defined below).

February 5, 2007 ("Trading Phase Date"): Final date for full operation of Regulation NMS-compliant trading systems of all automated trading centers (both SRO trading facilities and ADF participants) that intend to qualify their quotations for trade-through protection under Rule 611 during the Pilots Stocks Phase and All Stocks Phase (as defined below). The period from February 5, 2007 till May 21, 2007 was the "Trading Phase."

May 21, 2007 ("Pilot Stocks Phase Date"): Start of full industry compliance with Rule 610 and Rule 611 for 250 NMS stocks (100 NYSE stocks, 100 Nasdaq stocks, and 50 Amex stocks). The period from May 21, 2007 till July 9, 2007 was the "Pilot Stocks Phase."

July 9, 2007 ("All Stocks Phase Date"): Start of full industry compliance with Rule 610 and Rule 611 for all remaining NMS stocks. The period from July 9, 2007 till October 8, 2007 was the "All Stocks Phase."

October 8, 2007 ("Completion Date"): Completion of phased-in compliance with Rule 610 and Rule 611.

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<sup>2</sup> Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006) ("Extension Release").

In addition, the Commission, by separate order, exempted the SRO participants in the joint industry market data plans from compliance with the Allocation Amendment until April 1, 2007.<sup>3</sup>

The revised compliance dates were designed to provide additional time for the SROs to develop and install their new trading systems, as well as to give all securities industry participants an enhanced opportunity to complete their compliance preparations in the least disruptive and most cost-effective manner possible. Recently, the New York Stock Exchange,<sup>4</sup> a major U.S. equity market, requested a four-week extension of the Trading Phase Date. The NYSE stated that, due to delays in the rollout schedule for its Hybrid Market, the NYSE would not be in a position to comply with the requirements for "automated quotations," as defined in Rule 600(b)(3) of Regulation NMS, until the end of February 2007. The NYSE believed that continuing with the scheduled implementation of Rule 611, without appropriate testing and quality assurance for the NYSE trading systems, would jeopardize best execution for investors and put the securities industry and investors at risk.

The Commission agrees that implementing Regulation NMS without full participation by a major market such as the NYSE would jeopardize the smooth functioning of the U.S. equity markets. It therefore has decided to extend the Trading Phase Date until March 5, 2007. To reflect the extended Trading Phase Date and avoid coinciding with major trading days in June 2007, the Commission also has decided to extend the Pilot Stocks Phase Date until July 9, 2007, and the All Stocks Phase Date until August 20, 2007. In contrast, the Specifications Date of

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<sup>3</sup> Securities Exchange Act Release No. 53828 (May 18, 2006) (order exempting SROs from compliance with the Allocation Amendment until April 1, 2007).

<sup>4</sup> See letter from Mary Yeager, Assistant Secretary, New York Stock Exchange to Nancy Morris, Secretary, Commission, dated January 8, 2007.

October 16, 2006 has already passed and is not affected by this release. In addition, the Completion Date of October 8, 2007 remains unchanged.

Accordingly, the future compliance dates for Rule 610 and Rule 611, as revised by this release, are as follows:

Trading Phase Date: March 5, 2007. The revised Trading Phase now will extend from March 5, 2007 till July 9, 2007.

Pilot Stocks Phase Date: July 9, 2007. The revised Pilot Stocks Phase now will extend from July 9, 2007 till August 20, 2007.

All Stocks Phase Date: August 20, 2007. The revised All Stocks Phase now will extend from August 20, 2007 till October 8, 2007.

Completion Date: October 8, 2007.

In addition, the April 1, 2007 date for SRO participants in the joint-industry market data plans to comply with the Allocation Amendment is not affected by this release and remains April 1, 2007.

## **II. Conclusion**

For the reasons cited above, the Commission, for good cause, finds that notice and solicitation of comment regarding the extension of the compliance dates set forth herein are impractical, unnecessary, or contrary to the public interest.<sup>5</sup> All industry participants will receive substantial additional time to comply with Rule 610 and Rule 611 beyond the compliance dates originally set forth in the NMS Release, as modified by the Extension Release. In addition, the Commission recognizes that industry participants urgently need notice of the extended

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<sup>5</sup> See Section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) ("APA") (an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impractical, unnecessary, or contrary to the public interest").

compliance dates so that they do not expend unnecessary time and resources in meeting the previous compliance dates. Providing immediate effectiveness upon publication of this release will allow industry participants to adjust their implementation plans accordingly.<sup>6</sup>

By the Commission.

Nancy M. Morris  
Secretary

Date: January 24, 2007

*Florence E. Harmon*

By: Florence E. Harmon  
Deputy Secretary

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<sup>6</sup> The compliance date extensions set forth in this release are effective upon publication in the Federal Register. Section 553(d)(1) of the APA allows effective dates that are less than 30 days after publication for a "substantive rule which grants or recognizes an exemption or relieves a restriction." 5 U.S.C. 553(d)(1).

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 27676 / January 24, 2007

In the Matter of

FBR FUND ADVISERS, INC.  
FBR INVESTMENT SERVICES, INC.  
FBR INVESTMENT MANAGEMENT, INC.  
Potomac Tower  
1001 Nineteenth Street North  
Arlington, VA 22209

(812-13351)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT  
OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE  
ACT

FBR Fund Advisers, Inc. ("FBR Advisers"), FBR Investment Services, Inc. ("FBRIS") and FBR Investment Management, Inc. ("FBRIM") filed an application on December 22, 2006, which was amended on January 17, 2007, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting applicants and any other company of which Friedman, Billings, Ramsey & Co., Inc. is or becomes an affiliated person, other than any company of which Emanuel J. Friedman is or becomes an affiliated person (together, "Covered Persons"), from section 9(a) of the Act with respect to a securities-related injunction entered by the U.S. District Court for the District of Columbia on December 22, 2006.

On December 29, 2006, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting applicants from section 9(a) of the Act (Investment Company Act Release No. 27652) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.


The matter has been considered and it is found that the conduct of the applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

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Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by FBR Advisers, FBRIS, and FBRIM (File No. 812-13351), that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the U.S. District Court for the District of Columbia on December 22, 2006.

By the Commission.

A handwritten signature in cursive script that reads "Florence E. Harmon". The signature is written in dark ink and is positioned to the right of the "By the Commission." text.

Florence E. Harmon  
Deputy Secretary

*Commissioner Campos  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55177 / January 25, 2007

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2586 / January 25, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12550

In the Matter of

VERTICAL CAPITAL  
PARTNERS, INC. (now  
known as ARJENT LTD.)  
and FRANCESCA  
WOLFSOHN,

Respondents.

ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTION 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934 AND SECTION  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940.

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") and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Vertical Capital Partners, Inc. (now known as Arjent Ltd.) ("Vertical"), and Francesca Wolfsohn (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement ("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 Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the

*Document 46 of 54*

Securities Exchange Act of 1934 and Section 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

### III.

On the basis of this Order and Respondents' Offers, the Commission finds<sup>1</sup> that:

#### A. Summary

1. From 1999 and at least through the end of 2005, Vertical, a registered broker-dealer, sponsored a wrap fee program consisting of managed accounts traded by Wolfsohn, a registered representative at Vertical.<sup>2</sup> Account agreements for the managed accounts provided that Vertical would not charge loads or sales commissions on mutual fund purchases. Contrary to these provisions, and without disclosure to clients, between August 2002 and August 2004, Vertical charged managed account clients approximately \$530,000 in loads on mutual fund purchases. The overcharge was apparently the result of an error in Vertical's trade entry process. Both Wolfsohn and her direct supervisor, a senior Vertical executive, received, but failed to adequately review or investigate, monthly reports on Wolfsohn's compensation that should have alerted Respondents to the improper charges. Thus, they failed to detect the overcharge, and as a result, Vertical violated Section 206(2) of the Advisers Act and Rule 10b-10 under the Exchange Act, and Wolfsohn caused Vertical's violations of these provisions.

#### B. Respondents

2. Vertical,<sup>3</sup> formerly known as Security Capital Trading, Inc., and now known as Arjent Ltd., is a Delaware corporation with a primary place of business in New York, New York. Vertical has been registered with the Commission as a broker-dealer since 1995; it is not registered with the Commission as an investment adviser. In 2002-2004, Vertical had approximately 22 registered representatives. Most of them were located in the New York office of the firm; approximately five were in the smaller branch office located in Coral Springs, Florida.

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

<sup>2</sup> Vertical has represented to the Commission that it has decided to terminate the wrap fee program and that the balances in all of the managed accounts have been transferred to non-discretionary, commission-based accounts at the firm. Vertical has represented that Wolfsohn will continue to act as the registered representative for these accounts.

<sup>3</sup> As used herein, the name "Vertical" refers to Vertical Capital Partners, Inc. and all its predecessor and successor entities, including Security Capital Trading, Inc. and Arjent Ltd.

3. Wolfsohn has been a registered representative at Vertical since 1999. From the time she joined Vertical, Wolfsohn was the only Vertical registered representative handling the managed account program at issue in this proceeding.

C. Facts

4. From 1999, when Wolfsohn joined Vertical, and at least through the end of 2005, Vertical sponsored a wrap fee program consisting of managed accounts traded by Wolfsohn. Pursuant to their agreements with Vertical, clients in the managed account program paid Vertical quarterly management fees, calculated as a percentage of the managed assets, in exchange for Vertical's trade execution and portfolio management services. The managed account portfolios consisted primarily of mutual fund shares. Wolfsohn, in consultation with an outside adviser hired by Vertical, would develop an allocation of assets to fit the clients' investment needs and objectives, select the mutual funds to be purchased for the clients' accounts, and monitor and periodically adjust the portfolio holdings. The account agreements gave both Vertical and Wolfsohn investment discretion over the managed accounts. The agreements also provided that "LOAD Mutual funds purchased for the account[s] [would] not be charged a LOAD or sales commission and [would be] purchased at NET ASSET VALUE (NAV)." After payment of the outside adviser's fees, Wolfsohn received 60% of all fees generated by the managed accounts, and Vertical received the remaining 40%.

5. Until some time in 2002, Wolfsohn placed mutual fund trades for the managed accounts by giving a list of the trades to a Vertical clerk, who, in turn, faxed the list to the mutual fund department of Vertical's clearing firm. Some time in 2002, the clearing firm provided Vertical with direct access to a computerized mutual fund order entry system. The Vertical clerk who entered trades through that system, however, did not know that, for the managed accounts, she had to select the "NAV" price option from a dropdown menu of the trade entry screen. Instead, she entered trades at the default price appearing on the screen, which incorporated loads. As a result, between August 2002 and August 2004, Vertical charged the managed account clients \$530,048.49 in loads on mutual fund purchases. These charges directly contradicted the provisions of the clients' agreements with Vertical and were not disclosed to the clients either in the trade confirmations or otherwise.

6. Vertical charged loads on mutual fund purchases by managed account clients in contravention of explicit terms in its managed account agreements. Both Respondents received periodic information - "cover sheets," "commission runs," and Wolfsohn's monthly salary fluctuations - indicating that the managed accounts were paying sales loads. Thus, Respondents knew or should have known that the managed account holders were paying sales loads despite contrary terms in the account agreements. The conduct with respect to the managed account holders who were Vertical's investment advisory clients violated Section 206(2) of the Advisers Act. As a result, Vertical violated and Wolfsohn caused Vertical's violations of Section 206(2) of the Advisers Act.

7. Both Wolfsohn and her direct supervisor, a senior Vertical executive, regularly received but claim to have failed to adequately review or investigate certain reports that should have alerted both Respondents to the improper charges. During the relevant time, Wolfsohn had two

registered representative ("RR") numbers at Vertical, one solely for the trading in the managed accounts and one for the remaining Wolfsohn customer accounts. Every month, Vertical's clearing firm generated and sent to Vertical a separate "commission run" for each Wolfsohn RR number. These reports contained a listing of all trades placed with each RR number during the month as well as certain summary information. Among other things, the commission runs showed the sales charges, such as commissions or mutual fund loads, for each trade and the total sales charges for the month on trades in each security type, including on trades in mutual fund shares. Each month, Wolfsohn received a copy of these reports, and the Vertical clerk responsible for payroll processing received another copy. Until August 2002, the commission runs for the Wolfsohn managed account RR number showed zero sales charges on each mutual fund trade and also stated that the total sales charges on mutual fund trades for the month were zero. By contrast, beginning in August 2002, the commission runs for the managed account RR number showed non-zero sales charges on mutual fund trades, both for individual transactions and in total. Wolfsohn stated that she did not review the commission runs. Her supervisor stated that he did not receive them.

8. Additionally, Wolfsohn's direct supervisor, a senior Vertical executive, regularly received and reviewed so-called "cover sheets" - monthly one-page reports, prepared by the Vertical payroll clerk, summarizing the gross and net fees Wolfsohn earned during the month. On the cover sheets, the gross fees generated by each Wolfsohn RR number appeared as separate line items. Prior to August 2002, the cover sheets included an entry for the managed account RR number every third month, reflecting the quarterly management fees. By contrast, beginning in August 2002, the cover sheets showed gross fees from the managed account RR number virtually every month. Wolfsohn's supervisor, however, did nothing to investigate this change, nor did he do anything to ensure that the gross fees appearing on the cover sheets were correct. Instead, he merely checked the arithmetical accuracy of the calculations included on the cover sheets and then approved the payout.

9. The improperly charged loads constituted approximately 31%, 64% and 54% of Wolfsohn's gross earnings from Vertical in 2002, 2003 and 2004, respectively, and between 1.6% and 16.6% of Vertical's quarterly gross revenues during the time period at issue.

10. The staff of the Commission's Northeast Regional Office discovered the improper load charges in the managed accounts during its examination of Vertical in the summer of 2004. Vertical subsequently hired an outside accounting firm to audit the managed accounts to determine the extent of the overcharge and the reimbursement due to the clients. In January 2005, Vertical voluntarily sent letters to the affected clients, informing them that the firm had discovered "an error in [its] computerized order system which resulted in an overcharge on certain transactions involving loads" and offering each client a refund in the form of either a cash payment or a credit to the client's managed account. Vertical ultimately voluntarily refunded \$490,432.84 to the affected managed account clients. Additionally, \$39,712.03 or 60% of the refund due to the accounts owned by Wolfsohn and her immediate family members was waived by the account owners. Vertical did not pay clients interest on the reimbursed amounts. Wolfsohn contributed \$302,869.27 toward the reimbursement, representing approximately the loads that she received.

**D. Violations**

11. As a result of the conduct described above, Vertical violated and Wolfsohn caused Vertical's violations of Section 206(2) of the Advisers Act, which makes it "unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, ... to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act does not require a finding of scienter and may be established by a showing of negligence. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992).

12. Additionally, as a result of the conduct described above, Vertical violated and Wolfsohn caused Vertical's violations of Rule 10b-10 under the Exchange Act, which makes it unlawful for a broker-dealer to effect any transactions for a customer's account unless the broker-dealer, at or before the completion of the transaction, provides the customer with written notification disclosing, among other things, "[the] amount of any remuneration received or to be received by the broker from such customer in connection with the transaction." 17 C.F.R. § 240.10b-10(a)(2)(i)(B).

**E. Respondents' Remedial Efforts**

13. In determining to accept the Offers, the Commission has considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff.

**F. Undertakings**

14. Respondents undertake to take the following actions.<sup>4</sup>

Ongoing Cooperation

15. In determining to accept the Offers, the Commission has considered the following undertaking by Respondents. Respondents shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Respondents have undertaken:

- (a) To produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission's staff;
- (b) That Vertical will use its best efforts to cause Vertical employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;

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<sup>4</sup> The undertakings and sanctions set forth herein shall be binding upon all successors to Vertical, including Arjent Ltd.

- (c) That Vertical will use its best efforts to cause Vertical employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and
- (d) That in connection with any testimony of Respondents to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Respondents:
  - (i) Agree that any such notice or subpoena for Respondents' appearance and testimony may be served by regular mail on their attorney, and
  - (ii) Agree that any such notice or subpoena for Respondents' appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

#### Independent Compliance Consultant

16. Vertical shall retain, within 30 days of the date of entry of the Order, the services of an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission. The Consultant's compensation and expenses shall be borne exclusively by Vertical. Vertical shall require the Consultant to conduct a comprehensive review of Vertical's supervisory, compliance, and other policies and procedures designed to prevent and detect conflicts of interest, breaches of fiduciary duty, and federal securities law violations by Vertical and its employees. This review shall include, but shall not be limited to, a review of Vertical's policies and procedures in the areas of trade processing, compensation of registered representatives, and the training of registered and unregistered staff. Vertical shall cooperate fully with the Consultant and shall provide the Consultant with access to its files, books, records, and personnel as reasonably requested for the review.

17. Vertical shall require that, at the conclusion of the review by the Consultant, which in no event shall be more than 90 days after the date of entry of the Order, the Consultant submit a Report to Vertical and the staff of the Commission. Vertical shall require that the Consultant's Report address the issues described in paragraph 16 of this Order. Vertical shall also require that the Report include a description of the review performed, the conclusions reached, the Consultant's recommendations for changes in or improvements to Vertical's policies and procedures, and a procedure for implementing the recommended changes in or improvements to Vertical's policies and procedures.

18. Vertical shall adopt all recommendations contained in the Consultant's Report; provided, however, that within 120 days after the date of entry of the Order, Vertical shall in writing advise the Consultant and the staff of the Commission of any recommendations that Vertical considers to be unnecessary or inappropriate. With respect to any recommendation that Vertical considers unnecessary or inappropriate, Vertical 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.

19. As to any recommendation with respect to Vertical's policies and procedures on which Vertical and the Consultant do not agree, Vertical and the Consultant shall attempt in good faith to reach an agreement within 150 days of the date of entry of the Order. In the event Vertical and the Consultant are unable to agree on an alternative proposal, Vertical shall abide by the Consultant's determinations.

20. Vertical: (i) shall not have the authority to terminate the Consultant, without the prior written approval of the staff of the Commission; (ii) shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to the Order at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from transmitting any information, reports, or documents to the Commission or its staff.

21. Vertical shall require the 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 Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Vertical, 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 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 Consultant in performance of his/her duties under the Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Vertical, 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.

#### Disgorgement and Prejudgment Interest

22. Vertical's prior voluntary repayment of \$490,432.84 to managed account clients shall be deemed to satisfy its disgorgement obligations. Vertical shall distribute to managed account clients the sums ordered as prejudgment interest in paragraph D of part IV of the Order. Vertical shall distribute these sums in a manner designed to repay to each managed account client, with interest, the amount of loads improperly charged to that client's account(s). Within 60 days of the entry of this Order, Vertical shall certify to the staff of the Commission that it has made such payments and shall provide to the staff records of the payments, including the identities of the recipients, their addresses, the amounts they received, all records of Vertical's calculation of amounts due to each managed account client, and all records of communications between Vertical and the managed account clients concerning the payments. If Vertical is unable to pay any managed account client due to factors beyond its control, any portion of the sums ordered in paragraph D of part IV of the Order that is not paid to such client shall be paid to the United States Treasury within 120 days of the date on which Vertical

initially sends payment to such client. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Vertical as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Doria Bachenheimer, Assistant Regional Director, Securities and Exchange Commission, Division of Enforcement, Northeast Regional Office, 3 World Financial Center, Room 4300, New York, NY 10281-1022.

#### Certification

23. No later than twelve months after the date of entry of the Order, the chief executive officer of Vertical shall certify to the Commission in writing that Vertical has fully adopted and complied in all material respects with the requirements set forth in paragraphs 16-22 and 24 of the Order and with the recommendations of the Consultant or, in the event of material non-adoption or non-compliance, shall describe such material non-adoption and non-compliance.

#### Recordkeeping

24. Vertical shall preserve any and all records required to be created pursuant to paragraphs 16 through 22 of this Order in accordance with Rule 17a-4 under the Exchange Act. For all records of compliance with the undertakings set forth in paragraphs 16 through 22 above not otherwise required to be preserved pursuant to Rule 17a-4, Vertical shall preserve such records in accordance with Rule 17a-4(a) (i.e. for a period not less than six years, the first two years in an easily accessible place).

#### Deadlines

25. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

### IV.

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

Accordingly, it is hereby ORDERED that:

A. Vertical shall cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act and Rule 10b-10 under the Exchange Act.

B. Wolfsohn shall cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act and from causing any violations and any future violations of Rule 10b-10 under the Exchange Act.

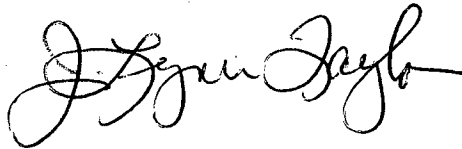
C. Vertical shall comply with the undertakings enumerated in paragraphs 16 through 24 above.

D. Vertical shall pay \$490,432.84, plus pre-judgment interest to managed account clients. Vertical's prior voluntary repayment of \$490,432.84 shall be deemed to satisfy its disgorgement obligations. Vertical shall pay to managed account clients, within 60 days of the date of entry of the Order, prejudgment interest in the total amount of \$38,076.61, consistent with the provisions of paragraph 22 above.

E. Nothing in this Order shall relieve Respondents of any other applicable legal obligation or requirement, including any rule adopted by the Commission subsequent to this Order.

By the Commission.

Nancy M. Morris  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-55165)

January 25, 2007

**Order Pursuant to Section 11A of the Securities Exchange Act of 1934 and Rule 608(e) Thereunder Extending a De Minimis Exemption for Transactions in Certain Exchange-Traded Funds from the Trade-Through Provisions of the Intermarket Trading System**

This order extends, through March 4, 2007, a de minimis exemption to the provisions of the Intermarket Trading System Plan ("ITS Plan"),<sup>1</sup> a national market system plan,<sup>2</sup> governing intermarket trade-throughs that currently is due to expire on February 4, 2007. The de minimis exemption was originally issued by the Commission on August 28, 2002<sup>3</sup> and extended on May

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<sup>1</sup> The self-regulatory organizations ("SROs") participating in the ITS Plan include the American Stock Exchange LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Chicago Stock Exchange, Inc., the National Stock Exchange, Inc. (formerly the Cincinnati Stock Exchange, Inc.), the National Association of Securities Dealers, Inc. ("NASD"), the New York Stock Exchange LLC, NYSE Arca, Inc. (formerly the Pacific Exchange, Inc.), and the Philadelphia Stock Exchange, Inc. (collectively, the "participants"). See Securities Exchange Act Release No. 19456 (January 27, 1983), 48 FR 4938 (February 3, 1983).

<sup>2</sup> Securities Exchange Act of 1934 ("Act") Rule 608(c) (formerly Rule 11Aa3-2(d)), 17 CFR 242.608(c), promulgated under Section 11A, 15 U.S.C. 78k-1, of the Act requires each SRO to comply with, and enforce compliance by its members and their associated persons with, the terms of any effective national market system plan of which it is a sponsor or participant. Rule 608(e) (formerly Rule 11Aa3-2(f)), 17 CFR 242.608(e), under the Act authorizes the Commission to exempt, either unconditionally or on specified terms and conditions, any SRO, member of an SRO, or specified security from the requirement of the rule if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.

<sup>3</sup> See Securities Exchange Act Release No. 46428 (August 28, 2002), 67 FR 56607 (September 4, 2002) (the "August 2002 Order"). The August 2002 Order granted relief through June 4, 2003.

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30, 2003,<sup>4</sup> on March 3, 2004,<sup>5</sup> on December 3, 2004,<sup>6</sup> on September 6, 2005,<sup>7</sup> and on June 28, 2006.<sup>8</sup>

Specifically, this order continues the de minimis exemption from compliance with Section 8(d)(i) of the ITS Plan with respect to two specific exchange-traded funds ("ETFs"), the Dow Jones Industrial Average ETF ("DIA") and the Standard & Poor's 500 Index ETF ("SPY").<sup>9</sup> By its terms, the June 2006 Order continued the exemption from the trade-through provisions of the ITS Plan of any transactions in the two ETFs that are effected at prices at or within three cents away from the best bid and offer quoted in the Consolidated Quote System ("CQS") through February 4, 2007.

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<sup>4</sup> See Securities Exchange Act Release No. 47950 (May 30, 2003), 68 FR 33748 (June 5, 2003) (the "May 2003 Order"). The May 2003 Order granted relief through March 4, 2004.

<sup>5</sup> See Securities Exchange Act Release No. 49356 (March 3, 2004), 69 FR 11057 (March 9, 2004) (the "March 2004 Order"). The March 2004 Order granted relief through December 4, 2004.

<sup>6</sup> See Securities Exchange Act Release No. 50795 (December 3, 2004), 69 FR 71445 (December 9, 2004) (the "December 2004 Order"). The December 2004 Order granted relief through September 4, 2005.

<sup>7</sup> See Securities Exchange Act Release No. 52382 (September 6, 2005), 70 FR 53695 (September 9, 2005) (the "September 2005 Order"). The September 2005 Order granted relief through June 28, 2006.

<sup>8</sup> See Securities Exchange Act Release No. 54063 (June 28, 2006), 71 FR 38433 (July 6, 2006) (the "June 2006 Order"). The June 2006 Order granted relief through February 4, 2007.

<sup>9</sup> The Commission limited the de minimis exemption to these two securities because they share certain characteristics that may make immediate execution of their shares highly desirable to certain investors. In particular, trading in the two ETFs is highly liquid and market participants may value an immediate execution at a displayed price more than the opportunity to obtain a slightly better price. Unlike prior orders, the December 2004, September 2005, and June 2006 extensions of the de minimis exemption applied only to the DIA and the SPY, and not the QQQ, because, on December 1, 2004, trading of the QQQ transferred from the American Stock Exchange to Nasdaq, and thus trades in the QQQ ceased to be subject to the trade-through provisions of the ITS Plan. Accordingly, an exemption for the QQQ was no longer necessary. See December 2004 Order, September 2005 Order, and June 2006 Order.

In the Commission's previous orders to issue and extend the de minimis exemption,<sup>10</sup> the Commission discussed its basis for determining that the de minimis exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.

In the June 2006 Order, the Commission further noted that:

In March 2004 and in May 2003, the Commission extended the three cent de minimis exemption for additional nine-month periods, in order to assess trading data associated with the de minimis exemption and to consider whether to adopt the de minimis exemption on a permanent basis, to adopt some other alternative solution, or to allow the exemption to expire. As a result of its review of trading data associated with the de minimis exemption, the Commission has proposed, as part of its market structure initiatives, Regulation NMS under the Act, which would include a new rule relating to trade-throughs.

On April 6, 2005, the Commission approved Regulation NMS under the Act.<sup>11</sup> In Regulation NMS, the Commission adopted an approach that, among other things, protects only automated quotations and excludes manual quotations from trade-through protection, and renders the de minimis exemption unnecessary. Given the significant systems and other changes necessary to implement Rule 610 and Rule 611,<sup>12</sup> the Commission originally established delayed compliance dates for Rule 610 and Rule 611, the first of which was scheduled to begin on June

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<sup>10</sup> See supra notes 3 to 8.

<sup>11</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

<sup>12</sup> Rule 610 generally prohibits national securities exchanges and national securities associations from imposing unfairly discriminatory terms that prevent or inhibit access to quotations, and establishes a limit on access fees, and requires each national securities exchange and national securities association to adopt, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross protected quotations. Rule 611 requires trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception.

29, 2006.<sup>13</sup> In the September 2005 Order, the Commission stated that until Regulation NMS is implemented, the reasons for maintaining the de minimis exemption in effect continue to be valid, and thus the Commission extended the de minimis exemption though June 28, 2006, which was the date before the initial compliance date for Rule 610 and Rule 611.

On May 18, 2006, the Commission extended the compliance dates for Rule 610 and Rule 611 to give trading centers additional time to finalize the development of their new or modified trading systems, and to give the securities industry sufficient time to establish the necessary access to such trading systems.<sup>14</sup> The initial compliance date was extended to a series of five dates, beginning on October 16, 2006, for different functional stages of compliance, with February 5, 2007 (the "Trading Phase Date") being the final date for full operation of Regulation NMS-compliant trading systems for initial trade-through protection under Rule 611, as described in the First NMS Extension Release. The Commission also extended the de minimis exemption through February 4, 2007, which was the day before the Trading Phase Date.<sup>15</sup>

On January 24, 2007, the Commission extended the Trading Phase Date to March 5, 2007.<sup>16</sup> Therefore, to maintain the status quo and avoid requiring market participants to make short-term trading or programming changes pending the extended implementation period for

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<sup>13</sup> See supra note 11.

<sup>14</sup> Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30037 (May 24, 2006) ("First NMS Extension Release").

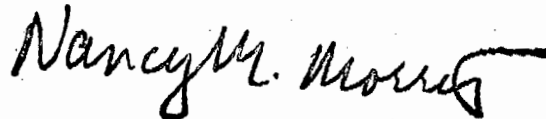
<sup>15</sup> See supra note 8.

<sup>16</sup> Securities Exchange Act Release No. 55160 (January 24, 2007) ("Second NMS Extension Release"). To reflect the extended Trading Phase Date and avoid coinciding with major trading days in June 2007, the Commission also extended the Pilot Stocks Phase Date (as defined in the Second NMS Extension Release) until July 9, 2007, and the All Stocks Phase Date (as defined in the Second NMS Extension Release) until August 20, 2007. In contrast, the Specifications Date (as defined in the Second NMS Extension Release) of October 16, 2006 has already passed and was not extended. In addition, the Completion Date (as defined in the Second NMS Extension Release) of October 8, 2007 was not changed.

Rule 610 and Rule 611 of Regulation NMS, it is appropriate to extend the de minimis exemption through March 4, 2007, the day before the extended Trading Phase Date.<sup>17</sup> The Commission emphasizes, as it did in the previous orders,<sup>18</sup> that the de minimis exemption does not relieve brokers and dealers of their best execution obligations under the federal securities laws and SRO rules.

Accordingly, IT IS ORDERED, pursuant to Section 11A of the Act and Rule 608(e) thereunder,<sup>19</sup> that participants of the ITS Plan and their members are hereby exempt from Section 8(d) of the ITS Plan during the period covered by this Order with respect to transactions in DIAs and SPYs that are executed at a price that is no more than three cents lower than the highest bid displayed in CQS and no more than three cents higher than the lowest offer displayed in CQS. This Order extends the de minimis exemption from February 5, 2007 through March 4, 2007.

By the Commission.



Nancy M. Morris  
Secretary

<sup>17</sup> The Commission expects most trading centers to be operating consistent with the requirements of Rule 611 by the Trading Phase Date.

<sup>18</sup> See supra notes 3 to 8.

<sup>19</sup> 17 CFR 242.608(e).

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**

Release No. 8776 / January 29, 2007

**SECURITIES EXCHANGE ACT OF 1934**

Release No. 55184 / January 29, 2007

**ACCOUNTING AND AUDITING ENFORCEMENT**

Release No. 2548 / January 29, 2007

**ADMINISTRATIVE PROCEEDING**

File No. 3-12551

**In the Matter of**

**MBIA Inc.,**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933 AND SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against MBIA Inc. ("MBIA").

**II.**

In anticipation of the institution of these proceedings, MBIA has submitted an 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 it and the subject matter of these proceedings, which are admitted, MBIA consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

*Document 48 of 54*

### III.

On the basis of this Order and MBIA's Offer, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. This proceeding arises out of a fraudulent transaction that MBIA executed to mask the true financial impact of a massive loss it suffered on its guarantee of municipal bonds. In 1998, MBIA learned that it would have to make good on its guarantee of \$256 million of bonds issued by a set of hospitals owned by the Allegheny Health, Education and Research Foundation ("AHERF"), which had defaulted. The default would have resulted in the first quarterly loss in MBIA's corporate history. To counter the potential negative market reaction, senior MBIA executives devised a scheme to obtain retroactive reinsurance that would cover the entire net present value of the anticipated loss, or about \$170 million, for a nominal premium. The effect of the transaction was to offset the entire \$170 million loss MBIA recorded on its income statement in the third quarter of 1998 with a roughly equivalent reinsurance recoverable, thus masking the AHERF loss and converting a quarterly loss into a gain. The transaction was a sham.

2. MBIA entered into three purported reinsurance contracts under which the reinsurers agreed to provide retroactive coverage of up to \$170 million for the AHERF loss (the "excess of loss" or "reinsurance" contracts). The excess of loss contracts were written as if it was unclear whether the reinsurers would have to provide the full amount of the agreed upon coverage, and MBIA's files were likewise papered to make this appear to be the case. This purported uncertainty about the extent of the reinsurers' payout to MBIA was critical to the desired accounting. To the extent that the reinsurers' payments under the excess of loss contracts were not expected to vary significantly, such payments could not be treated as reinsurance for accounting purposes, and MBIA would not be able to mask the effect of the AHERF loss on its income statement by offsetting the reinsurance recoveries against the loss. In fact, MBIA expected that the reinsurers would be called upon to pay out under the excess of loss contracts.

3. Because the reinsurers expected to pay out under the reinsurance contracts, they protected themselves against loss on the transaction by entering into separate agreements by which MBIA agreed to cede to them future business (the "quota share contracts"). The quota share contracts, which covered a significant percentage of MBIA's portfolio, ceded to the reinsurers hundreds of millions of dollars in premiums on future business. Although the ceding contracts did not on their face constitute compensation to the reinsurers (because the reinsurers were undertaking some limited risk associated with the ceded premiums), in substance, they were compensation, because the contracts ceded so little risk associated with the amount of premium received. Indeed, in the case of one reinsurer, which had agreed to pay \$70 million of MBIA's AHERF loss, MBIA ceded \$101 million in net premiums (representing \$13 billion of underlying insurance risk), but then secretly agreed to re-assume all but \$13 million of the risk in an oral side agreement, leaving

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

the reinsurer with all the ceded premium and virtually no risk. With respect to the other two reinsurers, which each paid \$50 million of the AHERF loss, MBIA ceded a tremendous volume of business based upon a formula that virtually assured that the reinsurers would be repaid in full for their payments under the excess of loss contracts, even taking into account the risk they would be undertaking on the ceded business.

4. In September 2004, the reinsurer with the oral side agreement sued MBIA to enforce the side agreement. The lawsuit led to an investigation by the Audit Committee of MBIA's Board of Directors, which concluded, in March 2005, that "it appears likely that such an [oral side] agreement" existed, and resulted in MBIA's restatement of its consolidated financial statements for the years 1998 through 2003. However, MBIA restated only the \$70 million of reinsurance associated with the side agreement. It did not restate the remaining \$100 million, which was improperly accounted for and which had been the subject of numerous misleading press releases and periodic filings.

5. As a result of the foregoing conduct, MBIA, directly and indirectly, has violated Sections 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1 thereunder.

#### **RESPONDENT**

6. **MBIA Inc.** is a Connecticut corporation headquartered in Armonk, New York. Through its principal operating subsidiary, MBIA Insurance Corporation ("MBIA Corp."), the company is a leading financial guarantor and provider of specialized financial services. MBIA Corp. has a financial strength rating of Triple-A from Moody's Investors Service, Standard & Poor's Ratings Services, Fitch Ratings, and Rating and Investment Information, Inc. MBIA's common stock trades on the New York Stock Exchange and it files periodic reports with the Commission pursuant to Section 13 of the Exchange Act.

#### **OTHER RELEVANT ENTITIES**

7. **AHERF** is a nonprofit operator of hospitals in Pennsylvania. In 1996, MBIA guaranteed \$256 million of bonds issued by a set of AHERF-owned hospitals known as the Delaware Valley Obligated Group ("AHERF bonds").

8. **Axa Re Finance** ("Axa") is an indirect subsidiary of Axa SA, an insurance group and asset management company headquartered in Paris, France. Axa SA's American Depositary Receipts trade on the New York Stock Exchange under the symbol AXA. One of Axa SA's primary subsidiaries is Axa Re, which focuses on the property and catastrophe reinsurance business. Axa is a wholly-owned subsidiary of Axa Re that was formed in 1997 to expand Axa Re's presence in the financial guarantee markets.

9. **Muenchener Rueckversicherungs-Gesellschaft AG** ("Munich") is a German corporation whose core businesses are reinsurance, primary insurance and asset management.

10. **Zurich Reinsurance (North America), Inc.** ("Zurich"), was, at the relevant time, a subsidiary of Zurich Financial Services Group, a Switzerland-based insurance and financial services company. Zurich is now known as Converium Reinsurance (North America) Inc., and is part of Converium Holding AG, an independent international multi-line reinsurer with headquarters in Switzerland.

**MBIA Engaged in a Fraudulent Scheme to Mask the Effect of the AHERF Loss On Its Earnings**

11. The AHERF loss was a significant event for MBIA. Not only was it the first sizeable loss in its history, but the loss exceeded MBIA's unallocated loss reserves by about \$100 million and was the subject of intense market concern. MBIA designed the AHERF reinsurance transaction specifically to address the anticipated market reaction by masking the effect of the loss on earnings. Ultimately, MBIA achieved the desired income statement effect by entering into an excess of loss contract and one or more quota share contracts with each of three reinsurers, the key monetary terms of which are summarized below.

<u>Counterparty</u>	<u>Excess of Loss Coverage</u>	<u>Quota Share Contract Gross Premiums</u>
Munich	\$50 million	\$98 million (\$28 million to be paid in fourth quarter 1998)
Axa	\$50 million	\$97 million (\$60 million to be paid by March 31, 1999)
Zurich	\$70 million	\$145 million (\$101.5 million net)
<b>Total:</b>	<b>\$170 million coverage</b>	<b>\$340 million gross ceded premium</b>

12. The quota share contracts were carefully devised to fully compensate the reinsurers for the amounts they expected to pay under the excess of loss contracts. In addition, they were structured and documented so as to pass scrutiny by MBIA's auditor. Specifically, certain aspects of the quota share contracts were changed or omitted and made the subject of separate, and in some instances secret, side deals.

### **MBIA's Business: Writing to a "Zero-Loss" Standard**

13. MBIA, primarily through its subsidiary MBIA Corp., is and was at all relevant times, engaged in providing financial guarantee insurance for municipal and other government bonds and for structured finance obligations. Financial guarantee insurance provides an unconditional and irrevocable guarantee of payment, when due, of the principal and interest or other amounts owing on insured obligations. The value of MBIA's guarantee is dependent on its credit rating, which historically has been Triple-A. That Triple-A rating in turn is dependent on MBIA's financial condition and its ability to control its losses.

14. Because MBIA underwrites to a "zero loss" standard, the chance of a loss on account of a default on the issues it guarantees is, by design, typically small. According to MBIA, "[e]very transaction [the company] look[s] at is structured to a no-loss standard to avoid losses even under the worst probable case scenario." Therefore, although a loss, even a significant one, was possible, the company operated using a business model that assumed there would be no such losses, and at the relevant time, its history demonstrated that such losses were rare.

### **The AHERF Loss and Its Effect on MBIA's Stock Price**

15. In 1996, the AHERF bonds were issued, with MBIA's guarantee. The AHERF bonds were not general obligation bonds backed by tax revenues. By the spring of 1998, it was apparent that AHERF was in financial distress and that MBIA would have to make good on its guarantee. As a result, the investment community was concerned about the possible negative impact on MBIA resulting from its AHERF exposure. This concern was exerting downward pressure on MBIA's stock price, which fell from a high of \$77.94 in April 1998 to a low of \$67.62 on June 15, 1998.

16. On July 21, 1998, AHERF filed for bankruptcy protection, and MBIA issued a press release stating that the AHERF bankruptcy would have no impact on its earnings because "the company's unallocated loss reserve [of approximately \$75 million] will be sufficient to meet anticipated losses." The market remained concerned, and MBIA's stock price continued to fall. On September 2, 1998, AHERF announced that its 1997 financial statements would be restated and should not be relied upon. By September 10, 1998, the price of MBIA's stock had fallen to \$46.30.

17. It was in this context that senior MBIA executives negotiated and executed the excess of loss and quota share contracts, for the purpose of masking the effects of the AHERF loss on MBIA's earnings and thus allaying the market's concern. The contracts were negotiated, structured, and documented by MBIA's then-chief executive officer and chairman of the board ("CEO") and its then-chief financial officer and later special assistant to the chairman ("CFO").

18. MBIA first announced a reinsurance solution during an investor call on September 11, 1998, and the news had an immediate positive impact on MBIA's stock price. By the close of business on September 11, the price had climbed to \$52.09 from \$46.30 the day before. Ultimately, in a September 29, 1998 press release, MBIA announced that it had obtained \$170

million in reinsurance for its anticipated AHERF loss and that as part of the reinsurance agreements it had "entered into strategic business relationships with highly rated reinsurers to provide them with future business." MBIA did not identify the reinsurers or provide details of the "strategic business relationships." After the issuance of this press release, and through the filing of MBIA's third quarter earnings release and Form 10-Q in mid-November, MBIA's stock price recovered so that by year end it was trading in the mid-\$60s.

19. The July press release and the September conference call and press release were deliberately or recklessly misleading. When the July release was issued, MBIA's own internal analysis was that the AHERF loss would likely exceed its unallocated loss reserves. When MBIA announced in the September conference call and the September press release that the loss would be covered by reinsurance, it knew that the excess of loss contracts were not agreements subject to reinsurance accounting but were in substance loans, and that the "strategic business relationships" were mechanisms designed to fully compensate the reinsurers for the amounts they had paid under the excess of loss contracts.

#### **The Terms of the AHERF "Reinsurance" Arrangement and the Applicable Accounting Principles**

20. The essence of the reinsurance arrangement was that Munich, Axa and Zurich each agreed to "reinsure" a portion of the AHERF loss retroactively, i.e., to pay MBIA for a loss that it had already incurred, in return for premiums on future MBIA business. The reinsurance arrangements took the form of excess of loss contracts, which were organized into three layers, with Munich bearing responsibility for the first \$50 million of the AHERF loss, Axa responsible for a second \$50 million layer, and Zurich responsible for a third \$70 million layer. (In an excess of loss reinsurance contract, a reinsurer pays its insured when the insured's loss is in "excess" of a set amount.) In return, MBIA agreed to pay the three insurers a nominal premium for the excess of loss contracts, and agreed to provide the reinsurers with, or "cede," future business, with total gross premiums of \$340 million, under quota share contracts. (In a typical quota share contract, the reinsurer takes on a percentage of risk for a percentage of the premium, minus the expenses of the company providing, or "ceding," the risk and associated premiums.)

21. To achieve the desired accounting treatment, which would permit MBIA to offset the \$170 million AHERF loss with the \$170 million reinsurance gain in the third quarter, MBIA knew that the excess of loss contracts had to transfer insurance risk on the date they were agreed upon. The applicable GAAP is Statement of Financial Accounting Standards Number 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts ("FAS 113"). Paragraph 9 of FAS 113 sets out the requirements for transferring insurance risk:

- a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts[; and]
- b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

A reinsurer shall not be considered to have assumed significant insurance risk under the reinsured contracts if the probability of a significant variation in either the amount or timing of payments is remote.

22. In addition, even if there had been sufficient variability as to the timing and amount of payments under the excess of loss contracts, to qualify for reinsurance accounting MBIA knew that it also had to be "reasonably possible that the reinsurer[s] [might] realize a significant loss on the transaction." To make that determination, the reinsurer's exposure and compensation on all the applicable agreements had to be considered. FAS 113, according to FASB Staff Implementation Guide on FAS 113, requires that:

[F]eatures of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured. (See EITF Topic No. D-34, question 13)

If, as was the case, it was not reasonably possible that the reinsurers would realize a significant loss on the arrangement, the payments under the excess of loss contracts could not be treated as reinsurance but rather would have to be accounted for as deposits.

23. In fact, the AHERF reinsurance arrangement failed the FAS 113 test because MBIA knew that its estimate of the loss was at least the amount of the reinsurance coverage, and each reinsurer expected to pay the full amount of its commitment. That fact alone meant that the arrangement could not be treated as reinsurance, even when combined with the quota share contracts. And because the quota share contracts were designed to compensate the reinsurers for their payments under the excess of loss contracts, it was not reasonably possible that the reinsurers would realize a significant loss on the excess of loss contracts.

#### **MBIA's Misleading Announcements About the Impact of AHERF**

24. On July 20, 1998, just one day before AHERF filed for bankruptcy protection, MBIA's surveillance department, which was responsible for preparing loss estimates for senior management, prepared a memorandum advising MBIA's president on reserving alternatives and press strategy regarding AHERF. The memo stated:

We think \$95-100MM – half way between the (highly unlikely) best case [of \$57 million] and the much more likely worst stress case [of \$136 million] is an appropriate starting point. We would expect that it is more likely than not we would have to ratchet the loss estimate up over the estimated two years it will take for the bankruptcy case to play out. On the other hand, the presence of four current bidders may give us a better outcome than currently expected. Accordingly, choosing a half-way number seems like a reasonable course at this point.

25. The president and the CEO rejected the surveillance department's recommendation for a \$95-\$100 million reserve. They did so because the figure exceeded MBIA's unallocated loss reserves, a fact that they did not want to disclose to the market. If MBIA announced its actual estimate of the loss, it would have had to disclose in its Form 10-Q for the second quarter, which was being prepared at the time, that the company expected its loss on AHERF to exceed its unallocated loss reserve.

26. On July 21, MBIA issued a press release, approved by the president and the CEO, which stated that MBIA expected that its unallocated loss reserve (then approximately \$75 million) would "be sufficient to meet anticipated losses from the bankruptcy filing," without any explanation of that conclusion. As a result, according to the release, "the company [did] not expect losses from this insured credit to affect its earnings."

27. The July 21 press release was false because it implied that MBIA's exposure on AHERF was less than \$75 million, when in fact the company's own surveillance department was anticipating a loss perhaps as much as \$136 million, and was recommending a reserve amount of \$95-100 million, far in excess of \$75 million.

28. On August 4, 1998, MBIA issued its second quarter earnings release. In the release, the CEO was quoted as saying that the company's unallocated loss reserves "will be adequate to handle the AHERF loss." This statement was restated essentially verbatim in MBIA's Form 10-Q for the quarter ended June 30, 1998, filed on August 14, 1998, in a note on subsequent events meriting mention. This statement was also incorporated in a prospectus MBIA filed on September 28, 1998 in connection with a \$150 million debenture offering, and in a later filing. The CEO had no reasonable basis to make such a statement because MBIA had no estimate of loss other than the surveillance department's suggested reserve of \$95-100 million.

29. On September 1, the day before MBIA entered into the excess of loss contracts with Munich and Axa, MBIA senior executives received a briefing on the status of AHERF from the surveillance department. At that briefing, they were told that "[a]t expected Ch. 11 auction sales ranges of \$500-650 [million], MBIA will suffer a [net present value] loss of \$100-150 [million] on [its AHERF bond] exposure of \$256 million net." Thus, by the eve of September 2, 1998, the earliest date by which MBIA claims to have reached agreements in principle to the purported reinsurance agreements with Munich and Axa, MBIA's loss estimates had climbed to approximately \$100-150 million.

30. On September 11, 1998, MBIA held a conference call for the stated purpose of addressing "the sharp and precipitous decline in MBIA's stock price over the last two weeks." That call, which had over 250 participants from major investment banks and institutional investors, specifically addressed, among other things, the AHERF situation. On the call, the president and the CEO made several statements about reinsurance the company was in the process of arranging to cover its AHERF exposure, including the following:

- “we have been making arrangements, not yet finalized, in the reinsurance marketplace which at very little cost has the effect of more than doubling the general loss reserve.”
- although the AHERF situation was “fluid,” MBIA “continue[s] to believe that after the arrangements we are making as to reinsurance . . . , the unallocated reserve that we have at present will cover any losses that will be incurred by MBIA as a result of [AHERF.]”
- MBIA “did not believe there would be any earnings impact from [AHERF.]”

31. The statements in paragraph 30 were false because MBIA knew that the excess of loss contracts were not agreements subject to reinsurance accounting but were in substance loans.

32. The statements by MBIA’s senior executives had the desired effect on the market. MBIA’s stock price rose 12.4% over the previous day’s close of \$46.30 to \$52.03, and remained in the \$50s through the end of September.

### **The Negotiations with the Reinsurers**

33. The quota share contracts ultimately reached with the reinsurers took advantage of the unusually low-risk, high-return nature of the financial guarantee business. MBIA’s business model, based on a “zero loss” underwriting standard, was exceedingly profitable. Historically, most of MBIA’s insureds, such as municipalities, other government entities and private issuers of structured finance obligations, were able to make all principal and interest payments from reliable sources of revenue, such as general tax revenues and private consumer receipts. Moreover, unlike traditional insurance, the entire amount of the premium on most municipal and other government entity guarantee insurance is paid up front, when the policy is written. Thus, in ceding business to the reinsurers, MBIA was in reality ceding an expected profit stream on a low-risk business.

34. Moreover, to make certain that the reinsurers would be reimbursed through the quota share contracts, MBIA agreed to modify its usual ceding commission, which is the amount the ceding insurer (MBIA) typically charges a reinsurer for ceding business. The “ceding commission” is typically a fixed percentage of the gross premium ceded. MBIA’s standard ceding commission was 32.5%; that is, MBIA usually retained 32.5% of the gross premiums it ceded to its reinsurers. But in the quota share contracts with Munich and Axa, MBIA used a sliding scale commission. For both Munich and Axa, MBIA agreed to lower its standard ceding commission from 32.5% to 17.5%, depending on the amount of losses the companies incurred on the risks they assumed. The sliding scale commission was a mechanism to help protect the profit that the reinsurers expected from the quota share contracts.

35. MBIA’s auditor reviewed the Munich and Axa quota share contracts to determine whether it was “reasonably possible that the reinsurer [might] realize a significant loss from the transaction,” when the excess of loss contract was combined with the quota share contract. The auditor advised MBIA senior executives that its quota share contracts with Munich and Axa as initially proposed did not pass the FAS 113 test. As a result, the agreements were changed and certain aspects were made the subject of separate agreements.

### **The Negotiations with Munich**

36. The negotiations with Munich began in late July, 1998. From the beginning, Munich assumed that it would be paying the full \$50 million on the excess of loss contract. As a result, the negotiations focused on the quota share contracts and making certain that Munich would be fully reimbursed. Under the initial quota share proposal, MBIA was to cede \$98 million in premiums to Munich with a sliding scale commission. MBIA also agreed that the premiums would be ceded on a facultative basis – that is that Munich could choose from among the business MBIA sought to cede to it, unlike a typical quota share contract in which the contract identifies the types of risk the reinsurer has agreed to accept and the insurer has agreed to cede, but does not allow the reinsurer to reject any risk of the type agreed upon. By having the right to select only the risks it wanted, Munich minimized its risk even further.

37. MBIA's auditor rejected the initial proposal because "the way it is currently structured there is no reasonable chance that [Munich] would lose money." The auditor indicated that in order to pass the risk transfer requirements, the premium ceded under the quota share contract with a sliding scale could not be more than \$70 million.

38. Because they knew that \$70 million would not be sufficient compensation for Munich, the MBIA senior executives proposed that MBIA and Munich enter into two agreements, the first for \$70 million, which the auditor had indicated would pass the FAS 113 test, and a second that ceded \$28 million in additional premiums. This second quota share agreement did not have a sliding scale, but provided that all premiums would be paid before the end of 1998. With that feature, the two contracts effectively achieved the objective of providing adequate compensation to Munich. And under the analysis MBIA's auditor employed, there was virtually no chance that Munich would lose money on the deal.

### **The Negotiations with Axa**

39. MBIA also began to negotiate the quota share contract with Axa in July. By the end of August, Axa expected that it would have to pay at least \$30 million of its excess of loss contract. Axa also knew, however, that there was a substantial chance that it may need to pay the full \$50 million due under the excess of loss contract.

40. To ensure that Axa would be fully compensated in either event, MBIA and Axa agreed that MBIA would cede \$60 million in premiums with a sliding scale commission under the excess of loss contract. Of this \$60 million, \$23 million was to be ceded by March 30, 1999. In addition, senior MBIA and Axa executives proposed what they referred to as a "gentlemen's agreement," which initially had a "springing quota share" feature, as well as a sliding scale commission. Under the "gentlemen's agreement," MBIA agreed to cede an additional \$37 million in premiums if Axa had to pay more than \$30 million on the excess of loss contract.

41. The MBIA and Axa senior executives had planned not to memorialize this "gentlemen's agreement." However, MBIA's auditor learned about the "gentlemen's agreement," and initially said that the arrangement could be part of the written contract. But after reviewing a

draft of the quota share agreement with the "springing" provision included, it said that such a provision could not be part of the written contract.

42. Axa and MBIA therefore entered into a quota share contract for \$60 million. On that basis, MBIA's auditor approved reinsurance accounting for the reinsurance arrangement with Axa.

43. MBIA and Axa also entered into the "gentlemen's agreement" that the auditor had rejected. This oral side agreement provided Axa with an additional \$37 million in premiums, also with a sliding scale commission. By the time the agreement was memorialized in December 1998, the "springing" feature was dropped, because it was known that Axa would have to pay the full \$50 million under the excess of loss contract. It was also agreed that the entire \$37 million was to be ceded by the end of the month. Consequently, of the \$97 million in total premiums ceded to Axa, \$60 million was to be ceded by March 30, 1999.

#### **The Announcement of the Reinsurance Solution and Its Impact on Earnings**

44. On September 29, 1998, the bankruptcy court conducted an auction of AHERF's assets. The auction resulted in gross proceeds of \$345 million. From this amount, MBIA later claimed that it was able to estimate a \$170 million net loss on AHERF. Also on September 29, MBIA issued a press release entitled "MBIA Announces Exposure to Bankrupt Pennsylvania Hospital Group to be Covered by Reinsurance Agreements; Expects no Impact on Earnings." In the press release, MBIA announced that it had "obtained \$170 million of reinsurance that it expects will cover anticipated losses arising from [AHERF]."

45. The September 29 release was false. On September 2, the earliest date by which MBIA claims to have reached agreements in principle with Munich and Axa for excess of loss coverage on the first \$100 million of its AHERF exposure, MBIA and the reinsurers knew that the best estimate of MBIA's loss was at least \$95 to \$100 million. Because there was no uncertainty as to the amount the reinsurers would pay, the excess of loss contracts did not transfer any risk under FAS 113. Moreover, the reinsurers expected to be fully compensated for their payouts, which also precluded reinsurance accounting under FAS 113.

#### **The Trouble with Zurich and the Secret Side Agreement**

46. After MBIA issued the September 29 press release, the purported deal between MBIA and Zurich collapsed as a result of issues raised by MBIA's auditor. This ultimately led to significant changes in the written contracts, and to the secret side agreement between Axa and MBIA relating to Zurich.

47. The negotiations with Zurich began in August. By September 28, Zurich and MBIA had exchanged a draft that provided both excess of loss coverage on AHERF and a quota share feature. The most prominent feature of the initial draft was that the agreement limited Zurich's exposure by capping its losses on the quota share contract.

48. By mid-to-late October, MBIA's auditor advised that for the company to obtain the desired accounting treatment, the caps on Zurich's losses on the quota share had to be removed. However, MBIA senior executives knew that Zurich would not accept more risk.

49. Thus, by that time, there was no Zurich deal. However, in its September 29 press release, MBIA had already told the market that it had three reinsurers lined up to reimburse it for losses relating to AHERF. Accordingly, the CFO, with the CEO's knowledge and approval, set about salvaging the Zurich layer of the excess of loss by arranging for another reinsurer to assume the bulk of Zurich's risk on the quota share.

50. As it happened, the unraveling of the Zurich deal coincided with a planned gathering for MBIA and Axa senior executives at a resort in Portugal, which occurred from October 26 through 28. The CEO and CFO attended for MBIA, and Axa's CEO and Chief Operating Officer attended along with its chairman, who was also the chairman and CEO of Axa's parent company.

51. In Portugal, the CFO approached Axa about assuming Zurich's risk under the quota share contract for a nominal premium. Axa said it would only do so if another reinsurer could be found to relieve it of that risk as it built on Axa's books, because even if the chance of paying out on those risks was low, Axa would be required to post reserves against the potential risk. During or shortly after the Portugal trip, the CFO and CEO assured Axa that MBIA would relieve Axa of the risk it had agreed to take on from Zurich. This side agreement was not reduced to writing and was not disclosed to MBIA's auditor.

52. In addition to the side agreement, Axa's agreement to take on Zurich's risk under the quota share contract resulted in three additional agreements because Zurich's payment under the excess of loss contract was to be funded by Interpolis Reinsurance Services, Ltd., a Dutch reinsurer. In exchange, Zurich gave to Interpolis the bulk of premiums it received from MBIA under the quota share contract, and Interpolis agreed to take on Zurich's risk from \$13 million to \$163 million. Axa took on this entire risk from Interpolis, through two separate agreements, one covering the risk from \$13 million to \$88 million, and the second covering the risk from \$88 million to \$163 million. In addition, Axa entered into a contract with Zurich under which it assumed Zurich's risk above \$163 million. In return, Axa received \$1 million in premium for each agreement, for a total of \$3 million. In other words, Zurich and Interpolis retained \$99 million in net premiums and retained only \$13 million of the risk associated with those premiums, in exchange for the \$70 million they provided MBIA to cover for the AHERF loss. Axa, on the other hand, assumed all the risk above \$13 million for only \$3 million in premium.

53. In short, the Zurich reinsurance arrangement involved limited transfer of risk to Zurich. Under the secret side agreement with MBIA, the risk under the quota share contract was transferred back to MBIA, except for \$13 million that was more than covered in full by the premiums that Zurich and Interpolis retained. In addition, by the time the deal was reached, there was no uncertainty or variability as to Zurich's payment under the excess of loss contract, because it was known by then that Zurich would have to pay the full amount of its commitment.

### **MBIA Created a Paper Trail to Justify Reinsurance Accounting**

54. In order to obtain the auditor's approval for the desired accounting treatment, MBIA senior executives created a paper trail to justify the reinsurance accounting. This paper trail included several affirmative misrepresentations about the agreements, including but not limited to the following:

- (a) First, MBIA represented that its estimate of its AHERF loss on the date on which it reached the reinsurance arrangements with Munich, Axa, and Zurich was less than the amount of excess of loss coverage agreed upon. Specifically, MBIA represented its estimate of loss at the time the reinsurance agreements were reached was \$0-\$117 million. This representation was false. By September 2, 1998, the earliest date by which MBIA claims the Munich and Axa agreements were purportedly in place, MBIA's surveillance department had estimated a loss of at least \$95-100 million, and possibly as high as \$150 million. The representation was also false with regard to Zurich because the deal that was in place in September was not the deal MBIA and Zurich ultimately entered into in October. By the time that deal was entered into, the AHERF loss was known to be at least \$170 million.
- (b) Second, the CEO and the CFO provided a letter for the auditor's files representing that MBIA had "an agreement in principal [sic]" with Zurich, and that "[t]he principal terms were agreed to on September 22nd with the understanding that certain refinements needed to be made to comply with standard reinsurance and accounting practices." The CEO and CFO each knew when they signed the representation letter that the agreement ultimately reached with Zurich was fundamentally different than the one that was contemplated in September, and they knew that the auditor was unaware of the side agreement in which MBIA effectively agreed to take back all but \$13 million of the risk it had ceded to Zurich under the quota share agreement.

### **MBIA's Misleading Financial Statements**

55. MBIA recorded the \$170 million Munich, Axa, and Zurich agreed to pay under the excess of loss contracts as a receivable in the third quarter of 1998, and its consolidated financial statements for the third quarter of 1998 and for the 1998 fiscal year included the entire amount as income.

56. In its November 3, 1998 earnings release, the company stated: "MBIA expects that any anticipated losses arising from [its AHERF exposure] will be fully covered by reinsurance. As a result, the company's third quarter earnings have not been affected by the bankruptcy." The release was filed on Form 8-K on November 4.

57. In its Form 10-Q for the quarter ended September 30, 1998, which was filed on November 16, 1998, MBIA stated that it had recorded "\$198 million of reinsurance recoverables" for the AHERF loss, which included the \$170 million receivable from Munich, Axa, and Zurich.

58. The recoverable under the purported reinsurance contracts, net of the nominal premium on those contracts, thus offset virtually the entire reported AHERF loss, which was recorded as an expense for the quarter. As a result, MBIA reported net income of approximately \$100 million for the third quarter and \$432 million for the year ended December 31, 1998, and diluted earnings per share of \$1.08 and \$4.32 for the respective periods.

59. MBIA's financial statements and the above-quoted representations in its releases and filings were false and misleading because it was improper to recognize the \$170 million as income and because MBIA did not disclose material facts that would have given the true picture of the transaction.

60. MBIA made these representations despite the fact that the CEO and CFO knew, or recklessly disregarded, that reinsurance accounting for the AHERF reinsurance arrangement was improper because there was no risk transfer under the excess of loss agreements and the reinsurers expected to be fully compensated for their payments under the excess of loss contracts by the quota share arrangements.

61. The AHERF reinsurance arrangement had a material and substantial impact on MBIA's reported earnings. Had the transaction been accounted for properly, as a financing, the \$170 million receivable under the excess of loss contracts would not have been reported as income in 1998. The income statement effect was substantial: it would have resulted in at least \$100 million less pre-tax income for the full year 1998 and, in the third quarter, would have resulted in MBIA's first quarterly loss. As a result of its fraudulent accounting for the recovery under the excess of loss contracts, MBIA was able to report that it "continu[ed] [its] unbroken streak of double-digit increases since [it] became a public company in 1987," as the company touted in its Annual Report for 1998.

#### **MBIA Continued to Misrepresent Its Results for 1998**

62. MBIA's misleading financial results for the 1998 third-quarter and fiscal year were republished in subsequent filings made in 1999, 2000, and 2001 and continued to create the false impression that the company had an uninterrupted succession of profitable quarters. Those filings continued to conceal the true facts about the purported reinsurance recovery on AHERF, including the side agreement between MBIA and Axa.

63. It was not until March 2005, after Axa filed suit in France, that MBIA publicly acknowledged the side agreement and the effect of it on its reported results for 1998. In March 2005, MBIA restated its consolidated financial statements for the calendar years 1998 through 2003 in light of the conclusion reached in the course of the internal investigation that the existence of a side agreement "appear[s] likely." The effect on the company's consolidated income statement for the third quarter of 1998 and fiscal year 1998 was to reverse the \$70 million gain attributable to the reinsurance receivable under the excess of loss contract with Zurich, which

originally had offset part of the \$170 million AHERF loss. MBIA also reversed the expense for the \$102 million in net premiums it had ceded to Zurich, which it then recognized as income over a six-year period beginning in 1999. In addition, the company eliminated the \$70 million receivable from Zurich originally reflected on its September 30, 1998 balance sheet.

64. The company did not restate its accounting for the other \$100 million of reinsurance, which was improper.

## **VIOLATIONS**

65. As a result of the conduct described above, MBIA violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities. MBIA made material misstatements and omitted material facts concerning the AHERF transaction in connection with its September 1998 debenture offering.

66. As a result of the conduct described above, MBIA 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. MBIA improperly recognized the \$170 million it received under the excess of loss contracts as income and did not disclose material facts concerning the AHERF transaction in its periodic filings that would have given the true picture of the transaction.

67. As a result of the conduct described above, MBIA violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20 thereunder, which require issuers to file true, accurate, and complete periodic reports with the Commission. Because of its misstatements and omissions of material facts concerning the AHERF transaction, MBIA filed false periodic reports and earnings releases with the Commission.

68. As a result of the conduct described above, MBIA violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets. Because MBIA improperly recorded the excess of loss and quota share contracts, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

69. As a result of the conduct described above, MBIA violated Section 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder, which require all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and prohibit them from, directly or indirectly, falsifying or causing to be falsified, any book, record, or account. MBIA's internal controls were not sufficient to prevent numerous false accounting entries related to the AHERF reinsurance agreements to be recorded that were not in conformity with generally accepted accounting principles.

## UNDERTAKINGS

MBIA undertakes to:

70. Cooperate fully with the Commission in any and all respects relating to or arising from the matters described in the Offer. In connection with such cooperation, MBIA undertakes to:

- (a) produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission's staff ("Staff");
- (b) be interviewed by the Staff at such times as the Staff reasonably may direct;
- (c) upon the request of the Staff, waive any applicable privilege with respect to MBIA's internal investigation concerning the matters addressed in this Order;
- (d) appear and testify truthfully and completely without service of a notice or subpoena as may be requested by the Staff;

71. Independent Consultant. In accordance with the procedure specified in subparagraph 71(k) below, retain, pay for, and enter into an agreement with an independent consultant, not unacceptable to the Staff ("Independent Consultant"), to conduct a comprehensive review of the areas specified in subparagraphs (a) and (b) below, and to make recommendations to MBIA's Board of Directors, after consultation with the Staff, regarding best practices in these areas. The agreement with the Independent Consultant shall contain the following provisions:

- (a) The Independent Consultant shall review:
  - (i) MBIA's accounting for, and disclosures concerning, its investment in Capital Asset Holdings GP, Inc., and
  - (ii) MBIA's accounting for, and disclosures concerning, its exposure on notes issued by the US Airways 1998-1 Repackaging Trust.
- (b) The Independent Consultant shall also review the design of the review conducted on behalf of the Audit Committee of MBIA's Board of Directors by Promontory Financial Group LLC, of MBIA's compliance organization and monitoring systems, internal audit functions, governance process and other controls including risk management, and records management policies and procedures ("Audit Committee Review"), and the implementation of any recommendations by Promontory.
- (c) The Independent Consultant shall issue a report to the Staff and MBIA's Board of Directors within six months of appointment, setting forth:
  - (i) with respect to the items identified at subparagraph 71(a) above, his or her findings on whether MBIA acted in a manner consistent with generally

accepted accounting principles ("GAAP") and the federal securities laws. With respect to any matter as to which he or she concludes that MBIA acted in a manner inconsistent with GAAP or the federal securities laws, he or she shall propose a plan of review designed to evaluate similar transactions or occurrences, if any, and provide reasonable assurance that all similar conduct inconsistent with GAAP or the federal securities laws has been identified and corrected; and

- (ii) with respect to the matters identified at subparagraph 71(b) above, his or her findings concerning whether the Audit Committee's Review was reasonably designed and implemented and, if not, any recommendations for further review to determine what policies and procedures should be implemented to achieve best practices.

The Report shall also include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for any changes in or improvements to MBIA's policies and procedures necessary to conform to best practices and a procedure for implementing the recommended changes in or improvements to MBIA's policies and procedures.

#### **Terms of Independent Consultant's Retention**

(d) In addition to the report identified above, the Independent Consultant shall provide the Staff and the Board of Directors with such documents or other information concerning the areas identified in subparagraphs 71(a) and (b), above, as any of them may request during the pendency or at the conclusion of the review.

(e) The Independent Consultant shall have reasonable access to all of MBIA's books and records, and the ability to meet privately with MBIA personnel. MBIA may not assert the attorney-client privilege, the protection of the work-product doctrine, or any privilege as a ground for not providing the Independent Consultant with contemporaneous documents or other information related to the matters that are the subject of the review. MBIA shall cooperate with the Independent Consultant, by, among other things, making available to the Independent Consultant the results of the investigation of Capital Asset conducted in 1999 by outside counsel at the direction of the Audit Committee of MBIA's Board of Directors. The Independent Consultant may consider and use the results of such prior investigation to the extent he or she deems appropriate in the course of conducting his or her own review. MBIA shall instruct and otherwise encourage its officers, directors, and employees to cooperate fully with the review conducted by the Independent Consultant, and inform its officers, directors, and employees that failure to cooperate with the review will be grounds for dismissal, other disciplinary actions, or other appropriate actions.

(f) The Independent Consultant shall have the right, as reasonable and necessary in his or her judgment, to retain, at MBIA's expense, attorneys, accountants, and other persons or firms, other than officers, directors, or employees of MBIA, to assist in the discharge of his or her obligations under these Undertakings. MBIA shall pay all reasonable fees and expenses of any persons or firms retained by the Independent Consultant.

(g) The Independent Consultant shall make and keep notes of interviews conducted, and keep a copy of documents gathered, in connection with the performance of his or her responsibilities, and require all persons and firms retained to assist the Independent Consultant to do so as well.

(h) As to the Commission and its Staff, the Independent Consultant's relationship with MBIA shall not be treated as one between an attorney and client. The Independent Consultant will not assert the attorney-client privilege, the protection of the work-product doctrine, or any privilege as a ground for not providing any information obtained in the review sought by the Staff.

(i) If the Independent Consultant determines that he or she has a conflict with respect to one or more of the areas described in paragraph 71 or otherwise, the responsibilities with respect to that subject shall be delegated to a person selected pursuant to the procedures set forth in subparagraph 71(k) below.

(j) 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 MBIA, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such; and shall 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 performance of the Independent Consultant's duties under this Order not, without prior written consent of the Staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with MBIA, 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. For the purposes of this section, representation of a person or firm insured by MBIA shall not be deemed a professional relationship with MBIA.

#### **MBIA Obligations Relating to the Independent Consultant**

(k) Within twenty days of the date of entry of this Order, MBIA will submit to the Staff a proposal setting forth the identity, qualifications, and proposed terms of retention of the Independent Consultant. The Independent Consultant's compensation and expenses shall be borne exclusively by MBIA, and shall not be deducted from any amount due under the provisions of this Order. After consultation and coordination with the New York Attorney's Office and the New York Insurance Department, the Staff, within thirty days of such notice, will either (a) approve MBIA's choice of Independent Consultant and proposed terms of retention or (b) require MBIA to propose an alternative Independent Consultant and/or revised proposed terms of retention within fifteen days. This process will continue, as necessary, until MBIA has selected an Independent Consultant on retention terms that are not unacceptable to the Staff (and the New York Attorney's Office and the New York Insurance Department.)

(l) MBIA shall adopt all recommendations contained in the report of the Independent Consultant referred to in subparagraph 71(c), above; provided, however, that within fifteen days of receipt of the report, MBIA shall in writing advise the Independent Consultant and the Staff of any recommendations that it considers to be unnecessary or inappropriate.

With respect to any recommendation that MBIA considers unnecessary or inappropriate, MBIA 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.

(m) As to any recommendation with which MBIA and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within thirty days of the issuance of the Independent Consultant's report referred to in subparagraph 71(c), above. In the event MBIA and the Independent Consultant are unable to agree on an alternative proposal, MBIA will abide by the determinations of the Independent Consultant.

(n) MBIA, including the board of directors and committees of the board of directors of MBIA, shall not assert the attorney-client privilege, the protection of the work-product doctrine, or any privilege as a ground for not providing any documents, information, or testimony requested by the Staff related to the review conducted by the Independent Consultant.

(o) MBIA shall retain the Independent Consultant for a period of nine months from the date of appointment. The Staff or MBIA may in either's discretion extend the Independent Consultant's term of appointment.

(p) Within ninety days of the receipt of the report referred to in subparagraph (c), MBIA shall certify to the Staff that all procedures recommended in the Independent Consultant's report, and any additional or alternative procedures agreed upon as a result of the procedure set out in subparagraphs 71(l) and (m), have been implemented, or will be implemented on a schedule agreed to by the Independent Consultant, and set out in the certification.

(q) With respect to any procedures to be implemented on a schedule agreed to by the Independent Consultant but not yet implemented by the date of the certification required pursuant to subparagraph 71(p), MBIA shall certify to the Staff within ten days after the end of the schedule agreed to by the Independent Consultant that all such procedures have been implemented.

### **Accountants' Report**

(r) MBIA shall engage certified public accountants, which may be MBIA's usual public accounting firm, to: (a) review whether MBIA acted in a manner consistent with GAAP and the federal securities laws in its accounting for, and disclosures concerning: (i) advisory fees, and (ii) the assets within Triple A One Funding, LLC, Polaris Funding Company LLC, and Meridian Funding Company, LLC; and (b) provide a written report of its review and conclusions to the Staff within sixty days of the entry of this Order ("Accountants' Report").

### **Miscellaneous Provisions**

(s) MBIA shall, at the Staff's discretion, (a) expand the scope of the Independent Consultant's engagement to include (i) the review of similar transactions or occurrences referred to at subparagraph 71(c)(i) above, or (ii) following the Staff's review of the Accountants' Report, MBIA's accounting for, and disclosures concerning: advisory fees, or the assets within Triple A One Funding, LLC, Polaris Funding Company LLC, and Meridian Funding Company, LLC.; and (b) extend any of the deadlines set out in this paragraph 71.

72. Pay the expenses and fees, if any, for the distribution of any Fair Fund established pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 established in the related civil action captioned Securities and Exchange Commission v. MBIA Inc., 07 Civ. 658 (JGK) (S.D.N.Y., filed Jan. 29, 2007).

73. Restate its financial statements in a manner not inconsistent with the findings in this Order.

74. In determining whether to accept the Offer, the Commission has considered the above undertakings.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in MBIA's Offer.<sup>2</sup>

Accordingly, it is hereby ORDERED that:

A. MBIA shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, and 13b2-1 thereunder.

B. MBIA shall comply with the undertakings enumerated in Paragraphs 71 and 72, above.

By the Commission.

  
Nancy M. Morris  
Secretary

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<sup>2</sup> Pursuant to the Consent of MBIA Inc. to Final Judgment filed in the action captioned United States Securities and Exchange Commission v. MBIA Inc., MBIA shall pay disgorgement in the amount of \$1 and a civil penalty in the amount of \$50 million under Section 20(d) of the Securities Act of 1933 and Section 21(d)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), which may be distributed pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002.

*Commissioner Campos  
Not Participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 8777 / January 30, 2007

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55200 / January 30, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-11175

In the Matter of

ROBERT OSTROWSKI and  
REES T. HARRIS,

Respondents.

ORDER DISMISSING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS INSTITUTED  
PURSUANT TO SECTION 8A OF THE  
SECURITIES ACT OF 1933 AND  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to enter an order dismissing these previously instituted public administrative and cease-and-desist proceedings brought, pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against respondents Robert Ostrowski ("Ostrowski") and Rees T. Harris ("Harris") (collectively, "Respondents").

II.

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 dismissing these proceedings, as set forth below.

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### III.

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

#### Respondents

1. Ostrowski is a resident of Kingston, Pennsylvania. From approximately 1960 until July 2001, Ostrowski was a registered representative and an associated person of Prudential Securities, Incorporated ("PSI"), a registered broker-dealer. He is not currently employed in the securities industry, and is retired.

2. Harris is a resident of Mountaintop, Pennsylvania. He was employed by PSI from 1968 until March 2001. He currently works as a registered representative for UBS Financial Services, Inc.

#### Other Relevant Entity

3. PSI has been registered with the Commission as a broker-dealer since 1939. PSI's main office is in New York City.

#### Background

4. On July 10, 2003, the Commission issued an Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("OIP") against Ostrowski and Harris. Since the institution of the OIP, there have been significant changes in both the law and related circumstances that make it advisable for the OIP to be dismissed.


### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to dismiss the OIP.

Accordingly, it is hereby ORDERED:

That the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 issued against Ostrowski and Harris on July 10, 2003 is hereby DISMISSED.

By the Commission.

  
Nancy M. Morris  
Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 55199 / January 30, 2007**

**ACCOUNTING AND AUDITING ENFORCEMENT**

**Release No. 2549 / January 30, 2007**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-12552**

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**In the Matter of**

**WILLIAM F. SORIN, ESQ.,**

**Respondent.**

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**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO RULE 102(e) OF THE  
COMMISSION'S RULES OF  
PRACTICE, 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 against William F. Sorin, Esq. ("Respondent" or "Sorin") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

**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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<sup>1</sup> 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, . . . suspend from appearing or practicing before it any . . . attorney . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

*Document 50 of 54*

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.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, 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. Sorin, 58, a resident of New York, New York, is an attorney who served as General Counsel and then Senior General Counsel of Comverse Technology, Inc. ("CTI") from October 1984 until his resignation on May 1, 2006. He also was Corporate Secretary and a Director of CTI during this time. Additionally, Sorin was a Director of Ulticom, Inc. ("Ulticom") and served on Ulticom's Compensation Committee from 2000 to June 2004. Sorin reviewed and signed each of CTI's annual reports on Form 10-K since at least 1991 and he reviewed each of CTI's quarterly reports on Form 10-Q during that time period. He drafted and reviewed all CTI's proxy statements and stock option plans during the relevant period.

2. CTI was, at all relevant times, a New York corporation, the subsidiaries of which provided software, systems and related services for multimedia communication and information processing applications. CTI was headquartered in Woodbury, New York, throughout most of the relevant period and currently maintains office space and/or operations facilities in Manhattan and Long Island, New York; its subsidiaries had operating facilities in Wakefield, Massachusetts; Tel Aviv, Israel and various other locations within the United States, Europe, Asia, South America, Africa and Canada. Prior to July 31, 2006, CTI's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the NASDAQ National Market System under the symbol "CMVT." It is now registered under Section 12(b) and continues to trade on the NASDAQ National Market System. CTI's fiscal year ends on January 31. Prior to 1998, CTI's fiscal year ended on December 31.

3. Ulticom is a New Jersey corporation based in Mount Laurel, New Jersey, that provides service enabling signaling software for fixed, mobile and Internet communications. Prior to July 31, 2006, Ulticom's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the NASDAQ National Market System under the symbol "ULCM." It is now registered under Section 12(b) and continues to trade on the NASDAQ National Market System. Prior to going public in 2000, Ulticom was a wholly-owned subsidiary of CTI. Ulticom is currently a majority-owned subsidiary of CTI. Ulticom's fiscal year ends on January 31.

4. On January 29, 2007, a final judgment was entered against Sorin, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b), 13(b)(5), 14(a), and 16(a) of the Exchange Act, and Exchange Act Rules 10b-5, 13b2-1, 13b2-2, 14a-9, and 16a-3, and for aiding and abetting violations of Sections 13(a),

13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13, in the civil action entitled Securities and Exchange Commission v. Jacob "Kobi" Alexander et. al, Civil Action Number 1:06-CV-03844-NGG-RER, in the United States District Court for the Eastern District of New York. Sorin was also prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act, and was ordered to pay \$2,488,424.10 in disgorgement, which includes prejudgment interest, and a \$600,000 civil penalty.

5. The Commission's Complaint alleges, among other things, that beginning no later than 1991, and continuing through 2001, Sorin engaged in a fraudulent scheme with CTI's former Chairman and Chief Executive Officer, and from at least 1998 with CTI's former Chief Financial Officer, to grant undisclosed, in-the-money options to themselves and others, by backdating stock option grants to coincide with historically low annual and quarterly closing prices for CTI's stock. Sorin then created company records that falsely indicated that CTI's Remuneration and Stock Option Committee (the "Compensation Committee") had actually acted on that date to make the options grant, when, in reality, no corporate action took place on the selected backdated date. According to the Complaint, Sorin's fraudulent misconduct caused CTI, between fiscal year 1991 and fiscal year 2005, (i) to file materially false and misleading financial statements that materially understated its compensation expenses and materially overstated its quarterly and annual net income and earnings per share, and (ii) to make disclosures in its periodic filings and proxy statements that falsely portrayed CTI's options as having been granted at exercise prices equal to the fair market value of CTI's common stock on the date of the grant. According to the Complaint, Sorin also misled CTI's outside auditors in an attempt to hide the scheme. The Complaint alleges that Sorin, and others, failed to file all required Commission Forms 3 and 4 to disclose his option-related activity and also filed Forms 3 and 4 that contained false or misleading statements with regard to the options' expirations dates (based on backdated grant dates) and the exercise prices. Beginning in 2000, the Complaint alleges that Sorin participated in a similar backdating scheme at Ulticom, a publicly-traded company whose stock was majority-owned by CTI, which resulted in Ulticom making materially false and misleading financial statements, and materially false and misleading disclosures regarding option grants, in its filings with the Commission.

IV.

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

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

Sorin is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.



Nancy M. Morris  
Secretary

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**January 31, 2007**

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**IN THE MATTER OF**

**Icon International Holdings, Inc.,  
Interchange Medical, Inc.,  
Outsource International, Inc., and  
Smart Choice Automotive Group, Inc.,**

**File No. 500-1**

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**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 Icon International Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Interchange Medical, Inc. because it has not filed any periodic reports since the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Outsource International, Inc. because it has not filed any periodic reports since the period ended April 1, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Smart Choice Automotive Group, Inc. because it has not filed any periodic reports since the period ended January 31, 2002.

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 above-listed companies is suspended for the period from 9:30 a.m. EST on January 31, 2007, through 11:59 p.m. EST on February 13, 2007.

By the Commission.



Nancy M. Morris  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
January 31, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12553

In the Matter of

Auto Wholesale Specialists, Inc.  
Globalbot Corp.,  
Gsociety, Inc.,  
Icon International Holdings, Inc. (f/k/a  
Marketing Systems USA, Inc.),  
Intelliworxx, Inc.,  
Interchange Medical, Inc.,  
Outsource International, Inc., and  
Smart Choice Automotive Group, Inc.,

Respondents.

ORDER INSTITUTING  
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").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Auto Wholesale Specialists, Inc. (CIK No. 1089981) is a dissolved Florida corporation located in Orlando, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Auto Wholesale is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of \$4,959 for the prior three quarters.

2. Globalbot Corp. (CIK No. 1129637) is a Florida corporation located in Hallandale, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Globalbot is delinquent in its periodic filings

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with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 21, 2001, which reported a net quarterly loss of \$37,074.

3. Gsociety, Inc. (CIK No. 922253) is a dissolved Florida corporation located in Miami, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Gsociety is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of \$718,395.

4. Icon International Holdings, Inc. (f/k/a Marketing Systems USA, Inc.) (CIK No. 1046277) is a Florida corporation located in Melbourne, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Marketing Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of \$416,827. As of January 22, 2007, the company's common stock (symbol "INIH") was quoted on the Pink Sheets, had seventeen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

5. Intelliworxx, Inc. (CIK No. 1076739) is a dissolved Florida corporation located in Sarasota, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Intelliworxx is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of \$1.16 million.

6. Interchange Medical, Inc. (CIK No. 1086218) is a Florida corporation located in Fort Lauderdale, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Interchange is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported no revenue and net losses of \$203,742. As of January 22, 2007, the company's common stock (symbol "ICGM") was quoted on the Pink Sheets, had five market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

7. Outsource International, Inc. (CIK No. 1013316) is a dissolved Florida corporation located in Delray Beach, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Outsource is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the fiscal year ended April 1, 2001, which reported that liabilities exceeded assets by \$33.6 million, and that the company had doubt about its ability to continue as a going concern. On June 11, 2001, the company filed a Chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Central District of California, which was converted to a Chapter 7 proceeding that is still pending. As of January 22, 2007, the company's common stock (symbol "OSIXQ") was quoted on the Pink Sheets, had one market maker, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

8. Smart Choice Automotive Group, Inc. (CIK No. 949091) is a dissolved Florida corporation located in Winter Park, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Smart Choice 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 January 31, 2002, which reported no revenues for that quarter. As of January 22, 2007, the company's common stock (symbol "SCHA") was quoted on the Pink Sheets, had five market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

9. All of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), 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 (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

11. As a result of the foregoing, Respondents 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 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 of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

### 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 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 of verifiable delivery.

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.

  
Nancy M. Morris  
Secretary

Attachment

**Appendix 1**  
**Chart of Delinquent Filings**  
*In the Matter of Auto Wholesale Specialist et al.*

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Auto Wholesale Specialists, Inc.</b>	10-KSB	12/31/02	03/31/03	Not filed	46
	10-QSB	03/31/03	05/15/03	Not filed	44
	10-QSB	06/30/03	08/14/03	Not filed	41
	10-QSB	09/30/03	11/14/03	Not filed	38
	10-KSB	12/31/03	03/30/04	Not filed	34
	10-QSB	03/31/04	05/17/04	Not filed	32
	10-QSB	06/30/04	08/16/04	Not filed	29
	10-QSB	09/30/04	11/15/04	Not filed	26
	10-KSB	12/31/04	03/31/05	Not filed	22
	10-QSB	03/31/05	05/16/05	Not filed	20
	10-QSB	06/30/05	08/15/05	Not filed	17
	10-QSB	09/30/05	11/14/05	Not filed	14
	10-KSB	12/31/05	03/31/06	Not filed	10
	10-QSB	03/31/06	05/15/06	Not filed	8
	10-QSB	06/30/06	08/14/06	Not filed	5
	10-QSB	09/30/06	11/14/06	Not filed	2
Total Filings Delinquent	16				
<b>Globalbot Corp.</b>	10-KSB	06/30/01	09/28/01	Not filed	64
	10-QSB	09/30/01	11/14/01	Not filed	62
	10-QSB	12/31/01	02/14/02	Not filed	59
	10-QSB	03/31/02	05/15/02	Not filed	56
	10-KSB	06/30/02	09/30/02	Not filed	52
	10-QSB	09/30/02	11/14/02	Not filed	50
	10-QSB	12/31/02	02/14/03	Not filed	47
	10-QSB	03/31/03	05/15/03	Not filed	44
	10-KSB	06/30/03	09/29/03	Not filed	40
	10-QSB	09/30/03	11/14/03	Not filed	38
	10-QSB	12/31/03	02/16/04	Not filed	35
	10-QSB	03/31/04	05/17/04	Not filed	32
	10-KSB	06/30/04	09/28/04	Not filed	28
	10-QSB	09/30/04	11/15/04	Not filed	26
	10-QSB	12/31/04	02/14/05	Not filed	23
	10-QSB	03/31/05	05/16/05	Not filed	20
	10-KSB	06/30/05	09/28/05	Not filed	16
	10-QSB	09/30/05	11/14/05	Not filed	14
	10-QSB	12/31/05	02/14/06	Not filed	11

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Globalbot Corp.</b>					
	10-QSB	03/31/06	05/15/06	Not filed	8
	10-KSB	06/30/06	09/28/06	Not filed	4
	10-QSB	09/30/06	11/14/06	Not filed	2
Total Filings Delinquent	22				

**Gsociety, Inc.**

10-KSB	12/31/02	03/31/03	Not filed	46
10-QSB	03/31/03	05/15/03	Not filed	44
10-QSB	06/30/03	08/14/03	Not filed	41
10-QSB	09/30/03	11/14/03	Not filed	38
10-KSB	12/31/03	03/30/04	Not filed	34
10-QSB	03/31/04	05/17/04	Not filed	32
10-QSB	06/30/04	08/16/04	Not filed	29
10-QSB	09/30/04	11/15/04	Not filed	26
10-KSB	12/31/04	03/31/05	Not filed	22
10-QSB	03/31/05	05/16/05	Not filed	20
10-QSB	06/30/05	08/15/05	Not filed	17
10-QSB	09/30/05	11/14/05	Not filed	14
10-KSB	12/31/05	03/31/06	Not filed	10
10-QSB	03/31/06	05/15/06	Not filed	8
10-QSB	06/30/06	08/14/06	Not filed	5
10-QSB	09/30/06	11/14/06	Not filed	2
Total Filings Delinquent	16			

**Icon International Holdings, Inc.**

10-KSB	06/30/01	09/28/01	Not filed	64
10-QSB	09/30/01	11/14/01	Not filed	62
10-QSB	12/31/01	02/14/02	Not filed	59
10-QSB	03/31/02	05/15/02	Not filed	56
10-KSB	06/30/02	09/30/02	Not filed	52
10-QSB	09/30/02	11/14/02	Not filed	50
10-QSB	12/31/02	02/14/03	Not filed	47
10-QSB	03/31/03	05/15/03	Not filed	44
10-KSB	06/30/03	09/29/03	Not filed	40
10-QSB	09/30/03	11/14/03	Not filed	38
10-QSB	12/31/03	02/17/04	Not filed	35
10-QSB	03/31/04	05/17/04	Not filed	32
10-KSB	06/30/04	09/28/04	Not filed	28
10-QSB	09/30/04	11/15/04	Not filed	26
10-QSB	12/31/04	02/14/05	Not filed	23
10-QSB	03/31/05	05/16/05	Not filed	20
10-KSB	06/30/05	09/28/05	Not filed	16

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Icon International Holdings, Inc.</b>					
	10-QSB	09/30/05	11/14/05	Not filed	14
	10-QSB	12/31/05	02/14/06	Not filed	11
	10-QSB	03/31/06	05/16/06	Not filed	8
	10-QSB	06/30/06	08/14/06	Not filed	5
	10-QSB	09/30/06	11/14/06	Not filed	2

Total Filings Delinquent

22

**Intelliworxx, Inc.**

10-KSB	12/31/01	04/01/02	Not filed	57
10-QSB	03/31/02	05/15/02	Not filed	56
10-QSB	06/30/02	08/14/02	Not filed	53
10-QSB	09/30/02	11/14/02	Not filed	50
10-KSB	12/31/02	03/31/03	Not filed	46
10-QSB	03/31/03	05/15/03	Not filed	44
10-QSB	06/30/03	08/14/03	Not filed	41
10-QSB	09/30/03	11/14/03	Not filed	38
10-KSB	12/31/03	03/30/04	Not filed	34
10-QSB	03/31/04	05/17/04	Not filed	32
10-QSB	06/30/04	08/16/04	Not filed	29
10-QSB	09/30/04	11/15/04	Not filed	26
10-KSB	12/31/04	03/31/05	Not filed	22
10-QSB	03/31/05	05/16/05	Not filed	20
10-QSB	06/30/05	08/15/05	Not filed	17
10-QSB	09/30/05	11/14/05	Not filed	14
10-KSB	12/31/05	03/31/06	Not filed	10
10-QSB	03/31/06	03/31/06	Not filed	10
10-QSB	06/30/06	08/14/06	Not filed	5
10-QSB	09/30/06	11/14/06	Not filed	2

Total Filings Delinquent

20

**Interchange Medical, Inc.**

10-KSB	12/31/02	03/31/03	Not filed	46
10-QSB	03/31/03	05/15/03	Not filed	44
10-QSB	06/30/03	08/14/03	Not filed	41
10-QSB	09/30/03	11/14/03	Not filed	38
10-KSB	12/31/03	03/30/04	Not filed	34
10-QSB	03/31/04	05/17/04	Not filed	32
10-QSB	06/30/04	08/16/04	Not filed	29
10-QSB	09/30/04	11/15/04	Not filed	26
10-KSB	12/31/04	03/31/05	Not filed	22
10-QSB	03/31/05	05/16/05	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Interchange Medical, Inc.</b>					
	10-QSB	06/30/05	08/15/05	Not filed	17
	10-QSB	09/30/05	11/14/05	Not filed	14
	10-KSB	12/31/05	03/31/06	Not filed	10
	10-QSB	03/31/06	05/15/06	Not filed	8
	10-QSB	06/30/06	08/14/06	Not filed	5
	10-QSB	09/30/06	11/14/06	Not filed	2
Total Filings Delinquent	16				

<b>Outsource International, Inc.</b>					
	10-Q	06/30/01	08/14/01	Not filed	65
	10-Q	09/30/01	11/14/01	Not filed	62
	10-Q	12/31/01	02/14/02	Not filed	59
	10-K	03/31/02	07/01/02	Not filed	54
	10-Q	06/30/02	08/14/02	Not filed	53
	10-Q	09/30/02	11/14/02	Not filed	50
	10-Q	12/31/02	02/14/03	Not filed	47
	10-K	03/30/03	06/30/03	Not filed	43
	10-Q	06/30/03	08/14/03	Not filed	41
	10-Q	09/30/03	11/14/03	Not filed	38
	10-Q	12/31/03	02/16/04	Not filed	35
	10-K	03/28/04	06/28/04	Not filed	31
	10-Q	06/30/04	08/16/04	Not filed	29
	10-Q	09/30/04	11/15/04	Not filed	26
	10-Q	12/31/04	02/14/05	Not filed	23
	10-K	04/03/05	07/04/05	Not filed	18
	10-Q	06/30/05	08/15/05	Not filed	17
	10-Q	09/30/05	11/14/05	Not filed	14
	10-Q	12/31/05	02/14/06	Not filed	11
	10-K	04/02/06	07/03/06	Not filed	6
	10-Q	06/30/06	08/14/06	Not filed	5
	10-Q	09/30/06	11/14/06	Not filed	2
Total Filings Delinquent	22				

**Smart Choice Automotive Group, Inc.**

10-K	04/30/02	07/29/02	Not filed	54
10-Q	07/31/02	09/16/02	Not filed	52
10-Q	10/31/02	12/16/02	Not filed	49
10-Q	01/31/03	03/17/03	Not filed	46
10-K	04/30/03	07/29/03	Not filed	42
10-Q	07/31/03	09/15/03	Not filed	40
10-Q	10/31/03	12/15/03	Not filed	37

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Smart Choice Automotive Group, Inc.</b>	10-Q	01/31/04	03/16/04	Not filed	34
	10-K	04/30/04	07/29/04	Not filed	30
	10-Q	07/31/04	09/14/04	Not filed	28
	10-Q	10/31/04	12/15/04	Not filed	25
	10-Q	01/31/05	03/17/05	Not filed	22
	10-K	04/30/05	07/29/05	Not filed	18
	10-Q	07/31/05	09/14/05	Not filed	16
	10-Q	10/31/05	12/15/05	Not filed	13
	10-Q	01/31/06	03/17/06	Not filed	10
	10-K	04/30/06	07/31/06	Not filed	6
	10-Q	07/31/06	09/14/06	Not filed	4
	10-Q	10/31/06	12/15/06	Not filed	1
Total Filings Delinquent		19			

Chairman Cox  
& Commissioners Campos  
Not Participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
January 31, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12554

In the Matter of

MICHAEL SASSANO,  
DOGAN BARUH, ROBERT  
OKIN and R. SCOTT ABRY,

Respondents.

ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933, SECTIONS 15(b)(6) AND 21C OF  
THE SECURITIES EXCHANGE ACT OF  
1934, SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
AND SECTIONS 9(b) AND 9(f) OF THE  
INVESTMENT COMPANY ACT OF 1940

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") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Michael Sassano ("Sassano"), Dogan Baruh ("Baruh"), Robert Okin ("Okin") and R. Scott Abry ("Abry") (collectively the "Respondents"), and in addition, Section 9(f) of the Investment Company Act against Baruh.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. **Michael A. Sassano III**, 35, resides in Miramar Beach, Florida, and New York, New York. From July 1995 until January 2003, CIBC World Markets Corp. ("World Markets") employed Sassano as a registered representative ("RR") in its CIBC Oppenheimer retail division, and specifically in its Private Client Services ("PCS") division. In January 2003, Sassano became a RR of Fahnestock & Co., Inc. ("Fahnestock"). In late 2003, Fahnestock changed its name to Oppenheimer & Co., Inc. ("Oppenheimer"). Sassano holds Series 7, 63 and 65 licenses. In

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March 2004, Oppenheimer indefinitely suspended Sassano, and in July 2004, he resigned from Oppenheimer.

2. **Dogan Baruh**, 30, resides in New York, New York. From June 1998 until January 2003, World Markets employed Baruh as a RR in its CIBC Oppenheimer retail division, and specifically in its PCS group as part of a group of RRs working with Sassano. In January 2003, he became a RR of Fahnestock. He holds a Series 7 license. In March 2004, Oppenheimer indefinitely suspended Baruh. In July 2004, Baruh resigned from Oppenheimer.

3. **Robert Okin**, 50, resides in Armonk, New York. From August 1997 to January 2003, Okin was a Managing Director serving as the Head of World Markets' PCS. Prior to June 2002, Okin supervised the Head of World Markets' Financial Services division. After June 2002, he was Abry's direct supervisor. In January 2003, Okin became an employee of Fahnestock and remained Abry's supervisor at Fahnestock. Okin is currently Head of Branch Distribution Systems at Oppenheimer. He holds Series 7, 8 and 63 licenses.

4. **R. Scott Abry**, 42, resides in Cos Cob, Connecticut. From 1997 until January 2003, World Markets employed Abry in its PCS as the branch manager of Sassano's branch. He served as the branch manager until January 2003, at which time he became a branch manager at Fahnestock and remained Sassano's branch manager. He holds Series 7, 9 and 10 licenses. In September 2003, Abry resigned from Fahnestock and became a branch manager in a New York City branch of another broker-dealer.

#### **B. OTHER RELEVANT ENTITIES**

5. **CIBC World Markets Corp.** is a New York based broker-dealer subsidiary of Canadian Imperial Bank of Commerce ("CIBC"), a Canadian financial and bank holding company. World Markets, through its CIBC Oppenheimer retail division, serviced high-net-worth individuals, money managers, and small corporations, including market timing hedge funds. In January 2003, World Markets sold its Oppenheimer retail division to Fahnestock. World Markets is registered with the Commission as both a broker-dealer and investment adviser. On July 20, 2005, the Commission instituted settled administrative and cease-and-desist proceedings against World Markets, finding that World Markets violated Section 17(a) of the Securities Act, Sections 7(c), 10(b), 11(d), 15(c) and 17(a) of the Exchange Act and Rules 10b-3, 10b-5, 17a-3 thereunder, Rule 22c-1 as adopted under Section 22(c) of the Investment Company Act and Regulation T promulgated by the Federal Reserve Board regarding the extension of margin credit. See In the Matter of Canadian Imperial Holdings Inc. and CIBC World Markets Corp., AP File No. 3-11987 (July 20, 2005).

6. **Fahnestock and Co., Inc.** ("Fahnestock") was a New York based broker-dealer which, in January 2003, through its parent holding company Fahnestock Viner Holdings, Inc., acquired the CIBC Oppenheimer retail division of World Markets. After the purchase, Sassano, Baruh, Okin and Abry became employees of Fahnestock, with Okin and Abry remaining Sassano and Baruh's supervisors until September 2003. In September 2003, Fahnestock changed its name

to Oppenheimer. Oppenheimer is registered with the Commission as both a broker-dealer and investment adviser.

### **C. THE FRAUDULENT MARKET TIMING SCHEME**

7. Sassano and Baruh collaborated with numerous hedge fund customers to deceptively market time mutual funds through a variety of deceptive practices. Okin and/or Abry knew of, and approved, these practices. Their fraudulent conduct was repeatedly detected by mutual funds and, from at least 1999 until September 2003, these mutual funds frequently sent World Markets and Fahnstock letters and emails complaining about abusive market timing trading by Sassano's and Baruh's customers. Sassano and Baruh used numerous strategies to help their hedge fund customers deceive the mutual funds, including the use of: (a) multiple accounts, (b) multiple RR numbers; (c) different branch numbers; (d) trades in smaller dollar amounts; (e) accounts at Charles Schwab & Co., Inc. ("Schwab") and FMR Corp. ("Fidelity") to continue market timing funds that had blocked their customers trading through World Markets; and (f) variable annuities. These were among their favorite tactics to enable market timing customers to deceive mutual funds and "stay under the radar" of the mutual funds' internal timing monitors. In addition, Baruh knowingly accepted numerous mutual fund orders after 4:00 p.m. ET and processed those orders as though they had been placed prior to 4:00 p.m. ET so that they received the same day's net asset value ("NAV"). Sassano's and Baruh's market timing customers understood the reason for these tactics was to deceive mutual funds and "stay under the radar" of the mutual funds' internal timing monitors.

#### **Market Timing and Late Trading**

8. "Market timing" refers to the practice of: (a) frequent buying and selling of shares of the same mutual fund, or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. While not illegal per se, market timing can harm other mutual fund shareholders because, among other things, it can dilute the value of the mutual fund's shares. Market timing can also disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer. As a result, mutual funds often monitor market timing activity and impose restrictions on excessive trading. Some mutual funds also send "block notices" to RRs whom the mutual funds suspect are engaged in market timing.

9. Rule 22c-1(a) under the Investment Company Act requires mutual funds issuing redeemable securities, their principal underwriters and dealers in their shares, and any person designated in the fund's prospectus as authorized to consummate transactions in fund shares to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. Mutual funds generally determine the daily price of their shares as of 4:00 p.m. ET. In these circumstances, orders received before 4:00 p.m. must be executed at the price determined as of 4:00 p.m. that day. Orders received after 4:00 p.m. must be executed at the price determined as of 4:00 p.m. the next trading day.

10. "Late trading" refers to the practice of placing orders to buy or sell mutual fund shares after the time as of which a mutual fund has calculated its NAV (usually as of the close of trading at 4:00 p.m. ET), but receiving the price based on the prior NAV already determined as of 4:00 p.m. Late trading enables the trader to profit from market events that occur after 4:00 p.m. but that are not reflected in that day's price. In particular, the late trader obtains an advantage – at the expense of the other shareholders of the mutual fund – when he learns of market moving information and is able to purchase (or sell) mutual fund shares at prices set *before* the market moving information was released. Late trading violates Rule 22c-1(a) under the Investment Company Act and harms other shareholders when late trading dilutes the value of their shares.

### **Deceptive Market Timing and Late Trading Practices**

11. Sassano created a large and successful market timing business in which he executed mutual fund orders on behalf of his customers – large market timing hedge funds. Sassano's market timing business became so successful it made him one of the top-producing RRs at World Markets. From 1998 to 2002, World Markets paid Sassano over \$12.3 million. In 2003, Fahnstock (which had then changed its name to Oppenheimer) paid Sassano over \$3 million. As his business grew, Sassano hired additional people to work in his group, and he directed their activities. At its peak, Sassano had numerous people working in his group. Sassano's right hand man throughout the period of the fraud was Baruh.

12. Sassano's and Baruh's market timing business was well known to Okin and Abry. Because it was highly profitable, World Markets supported Sassano's and Baruh's market timing business and even afforded them the exclusive right to engage in market timing. For example, in March 2000, Sassano sent an email to, among others, Okin, to "reaffirm our restricted list" of mutual funds that only Sassano and his customers could market time. Sassano made this request "in order to prevent any disruption in my business." Okin approved Sassano's request and reaffirmed his exclusive ability to market time these funds. Indeed, at various times thereafter, Okin reprimanded other RRs at World Markets and Fahnstock trying to market time on behalf of their customers, noting such behavior was the exclusive purview of Sassano.

13. Sassano also requested, and Okin approved, the creation of an electronic trading platform at World Markets to facilitate Sassano's market timing business. Thus, World Markets created the Mutual Fund Exchange System ("MFES") exclusively for Sassano. The MFES allowed Sassano's customers to submit their mutual fund trades via electronic spreadsheet, which Sassano could then electronically convert into orders within World Markets' system. The MFES had the added benefit of allowing customers to submit multiple smaller trades within one account as a way to stay under the radar of mutual funds' internal timing monitors.

14. Respondents actively assisted market timing customers in deceiving mutual funds. Among the deceptive practices that Respondents' engaged in on behalf of their customers were the following: (a) using multiple accounts, including the "cloning" of new accounts, in order to evade blocks placed on known market timers by mutual funds; (b) creating new RR numbers to disguise timers and their RRs from mutual funds; (c) sending trades from a different branch to deceive the mutual funds about the origins of the trade; (d) trading in smaller amounts to not be

detected as timers by mutual funds, including using an in-house electronic trading platform to break up trades into small dollar volumes; (e) using other broker-dealers that had other trading platforms, such as Schwab and Fidelity, to continue market timing mutual funds that had blocked their customers' trading through World Markets; and (f) using annuities to market time. The hedge funds knew of, and endorsed, this wrongful conduct.

15. From at least August 2001 to November 2002, Baruh and another RR in Sassano's group accepted numerous trade orders from at least one of their market timing hedge fund customers before 4:00 p.m. ET, with the understanding that Baruh and the RR would not receive final instructions on executing the proposed trades until after 4:00 p.m. Further, despite the fact that the trading decision was made after 4:00 p.m., the understanding was that the proposed trades would be priced as of 4:00 p.m. Typically, the customer would fax its proposed trades to Baruh before the market closed. Thereafter, the customer would call and instruct whether to execute the proposed trades. These calls very often occurred after 4:00 p.m., allowing the customer to observe the after-hours markets.

#### **Use of Multiple Accounts**

16. Sassano, Baruh and others in Sassano's group acting at their direction opened multiple accounts for their customers to disguise the identities of the account holders and to continue market timing on behalf of customers that mutual funds had previously blocked. Creating new accounts enabled a timer to evade blocks mutual funds had placed on their previous timing accounts.

17. For instance, between November 13, 2001 and December 20, 2001, Sassano, Baruh and others in Sassano's group acting at their direction cloned 12 accounts for one of Sassano's market timing customers so that the customer could continue trading in one mutual fund after receiving notices prohibiting further trading in that fund. Specifically, between November 13, 2001 and November 27, 2001, Sassano, Baruh and others acting at their direction executed market timing trades in the international mutual fund in two of the customer accounts. As a result, the mutual fund, on November 28, 2001, blocked those accounts due to "a pattern of excessive trading." To evade those trading restrictions, between December 4, 2001 and December 6, 2001, Sassano, Baruh and others acting at their direction executed timing trades in the mutual fund in eight different accounts for the same customer whose accounts had been previously blocked. On December 7, 2001, the mutual fund blocked those eight accounts, again due to "excessive trading." Finally, to evade the November and December blocks, on December 14, 2001, Sassano, Baruh and others acting at their direction executed trades in the mutual fund in two more accounts for the same customer, leading the mutual fund, on December 20, 2001, to block these two new accounts from further trading.

18. Baruh, on Sassano's behalf, recommended that customers create additional accounts for trading. For example, Baruh recommended to a hedge fund customer that it create additional accounts so it could better market time mutual funds. The customer had multiple accounts at World Markets. For another customer whose accounts were blocked by a mutual fund because of excessive market timing, Baruh recommended that, to get around these restrictions, the

customer purchase shares of the mutual fund in the five additional accounts it had that had never purchased shares of that fund.

19. Some mutual funds figured out that Sassano and Baruh enabled their customers to clone accounts to evade blocks and notified World Markets and Fahnestock that they disapproved of the practice. For example, in October 2002, Mutual Fund Company A sent a letter to World Markets banning Sassano from executing further market timing in their funds. Despite World Markets' assurances that Sassano would stop, by December 2002, Sassano's group had 27 new market timing accounts that Mutual Fund Company A had shut down. When Mutual Fund Company A complained, World Markets again assured Mutual Fund Company A that Sassano's market timing would cease. Despite this, Sassano's group continued to time Mutual Fund Company A in new accounts. Consequently, in January 2003, Mutual Fund Company A called World Markets to complain. As explained in a January 14, 2003 email to Sassano and Baruh, Mutual Fund Company A was "frustrated by the fact that you stop timing in current accounts when they ask only to show up later in others."

#### **Use of Multiple Registered Representative Numbers**

20. Mutual funds often identified customer accounts that were engaged in market timing by RR numbers. Sassano and RRs in his group used multiple RR numbers to deceive mutual funds about the source of market timing trades. Using alternative RR numbers allowed them to disguise their identity and fool the mutual funds into believing that they had not been previously blocked from trading. This became increasingly important as the Sassano group's business grew and mutual funds began to identify their RR numbers as the source of abusive trading. All told, Sassano and his group had 57 individual or shared RR numbers at World Markets.

21. Okin and Abry were aware of these practices. For example, on November 4, 2002, Baruh sent Abry an email "wondering if we would be able to get a new rep number. If possible it would be great if that rep read MAS (as in Mike's initials as opposed to having his name) and have the rep go 100% to Mike's production." Abry forwarded this request on, until it reached World Markets' Registration Department. When asked why the rep would not be structured "to easily identify who this # belongs to," Baruh responded:

The reason why we would like to have Mike's initials as opposed to his name is certain fund families have blocked Mike's name from even purchasing their funds. This is because they have associated just the name on the rep as a "market timer." Without going too much into details, not all of Mike's business is [m]arket timing, and we are prevented from purchasing these funds simply because they are associating his name with a known market timer. So if these accounts were coded as MAS the funds will let us buy the mutual funds and we would not be restricted.

This explanation did not sit well with the Registration Department, which was "very hesitant to approve something based on the need to misrepresent or conceal information." Abry received this entire email chain.

22. On November 13, 2002, the Vice President of Compliance at Mutual Fund Company B, called the Director of Compliance at World Markets. As the Director of Compliance at World Markets explained in an email the next day to Okin and Abry (among others):

The purpose of the call was to once again communicate to CIBC that [Mutual Fund Company B] would no longer tolerate the market timing activity that Michael Sassano engages in on behalf of his clients through [Mutual Fund Company B]. Since 4/3/02, I have received three different letters (attached below) from [Mutual Fund Company B] requesting that Michael 'make no further investments in [Mutual Fund Company B]'. . . . He believes that Michael is deliberately attempting to conceal his association with this activity by creating numerous RR#s and breaking up the orders to smaller amounts so that the market timing goes undetected. . . . [I]n light of the potential impact on other CIBC businesses (U.S. Equities, Asset Mgmt) and the fact that [Mutual Fund Company B] has threatened to complain to the NASD, I believe that there are significant business and regulatory risks associated with Sassano's continued market timing through [Mutual Fund Company B].

23. Approximately a week later, the Director of Compliance at World Markets called Okin to follow up on his email. Okin, however, dismissed him, saying this was a business issue, not a compliance issue. The Director of Compliance strongly disagreed, again reiterating his belief that Sassano's conduct was a compliance issue. Despite this, Okin refused to follow up on Mutual Fund Company B's complaint or the concerns of the Director of Compliance at World Markets.

24. On November 21, 2002, Baruh emailed the Mutual Fund Operations Department to "make sure that everyone in the group knows what happens when they supply the fund families with the name on the rep. We are having a difficult time having the trades go through already, and if we help out the funds in tracking us down it will be that much harder."

25. After the Registration Department denied Baruh's request for an RR number with only initials, Baruh tried a different tack. In January 2003, Baruh and another RR working for Sassano ("RR Doe"), had their own RR numbers. On January 15, 2003, Baruh sent an email to Abry's administrative assistant. In it, Baruh indicated that he and RR Doe "wanted to start using these [RR #s] and open new accounts but have 100% of the proceeds/commissions generated from those two [RR #s] be credited to Mike's [Sassano] general rep number." That same day, their request was approved. Thereafter, all revenue attributable to Baruh's RR number 171 and RR Doe's RR number 271 were paid to Sassano.

26. Baruh then told the other RRs in Sassano's group that "in the future when we buy [shares of a certain mutual fund], . . . [d]efinitely do the buys under [RR Doe's] rep (271)[;] they are looking into the Sassano name." Baruh also told Mutual Fund Operations that if a certain

mutual fund called about recent purchases to "ask what rep this is[,] give them rep [RR Doe]." He also told Mutual Fund Operations that "[i]f they ask if it is timing tell them no."

27. Baruh also submitted trades to mutual funds while purposely omitting Sassano's name or using fake RR numbers as a way to "trick" the mutual funds. For example, in response to a question from a customer concerning its ability to open accounts without Sassano's name, Baruh responded: "We can do it. . . . I've done trades not under Mike's name, so Mike's name don't [sic] come up. . . . I'll get back a trade a few days later and be like who's rep 000 for example, you know, and they're like, that's nobody, and then they know that it's a trick that we played on them."

#### **Use of Different Branch Numbers**

28. Respondents also disguised timing trades by using a different branch code in their customer's account numbers. Each World Markets customer account included a three-digit branch code as a prefix to the account number. The branch code for the New York branch that Sassano was assigned to was "033." Once it became clear to mutual funds that blocking account numbers and RR numbers would not stop Sassano, many of them threatened, and then actually began, to block the entire 033 branch from trading. Consequently, on September 19, 2002, Baruh emailed Abry to request a "super branch" for the Sassano group. As Baruh explained:

The reason for the super branch is two fold. Sometimes the mutual fund companies in order to restrict us from trading ban branch 033 from doing any business. This has rarely happened but I'm sure you can understand the significance of banning branch 033, when we are the only ones they would like to restrict. So in essence this is for the firms [sic] benefit.

29. Abry forwarded this request to World Markets' Director of Operations, who noted that "If the funds find out we are screwing around they will throw us out." Abry replied: "They are throwing us out anyway, maybe we can prolong the agony we sure could us[e] the revenue."

30. On October 15, 2002, Mutual Fund Company C blocked Sassano's branch from any further purchases because of Sassano's repeated market timing activity. Shortly thereafter, on October 25, 2002, Sassano emailed Okin asking if "any headway" had been made on his request for his own branch. Okin forwarded this request to World Markets' Director of Operations, asking "is there a way to set up a [d]ifferent 3 digit start to his accounts?" World Markets' Director of Operations responded, "What [he's] trying to do is hide himself from the funds. If they find we are trying to backdoor them....." Okin agreed: "I assume that's what he's trying-I am okay with saying no, we can't. I would love a good reason though." To which World Markets' Director of Operations replied, "I think jeopardizing our fund relationships is a pretty good reason."

31. At the same time that Mutual Fund Company C was blocking the market timing activity, Sassano formed a joint RR number with a RR in World Markets' Boca Raton office, for a new market timing customer. On October 3, 2002, Baruh emailed the Boca Raton branch manger, asking him to open new accounts for the customer out of the Boca Raton branch. The Boca Raton

branch manger responded, "Since you [the Sassano group] are handling the account, the account should be domiciled in the 033, NY office and have [the Boca Raton RR] just be split on this account." Baruh, however, insisted that the accounts be opened in Boca Raton, which allowed Sassano's group to evade blocks mutual funds had placed on the 033 branch.

32. Later, on April 28, 29 and May 2, 2003, Baruh executed a number of trades for Sassano's Boca Raton customer. In doing so, however, Baruh told the Mutual Fund Operations Department not to inform the mutual fund that Sassano entered the trades. Rather, Baruh told the Mutual Fund Operations Department that, "should the mutual fund company call tomorrow, please just give them the [Boca Raton RR] rep name."

#### **Use of Smaller Dollar Amounts**

33. Another method Respondents used to disguise their timing from funds was to stay "under the radar" of the funds by trading in small dollar amounts. Sassano's group opened multiple accounts for their timing customers to spread timing money across multiple accounts, instead of trading one large lump sum, which would be a "red flag" to mutual funds. By trading in this way, they deceived the mutual funds into accepting large timing trades that the mutual funds would otherwise reject, by making the large trades appear as several smaller trades.

34. For example, on August 28, 2002, Baruh wrote to the Mutual Fund Operations Department concerning the Sassano group's identical smaller dollar amount trades in multiple customer accounts. Apologizing for the increased work these trades were causing the Mutual Fund Operations Department, Baruh wrote, "We obviously aren't purposefully trying to create more work for you guys by splitting these trades up. We are trying to break them up so the fund companies do not think these are market timing accounts, even though they are."

35. Okin knew about the Sassano group's use of multiple accounts. In June 2002, Baruh had emailed Okin asking for a lower margin rate for a customer. As Baruh explained, "[t]here are three accounts (even though it is the same client) that add up to approx. \$4,300,000. The reason they have three separate accounts is to stay under the radar with the mutual fund companies, otherwise it is the same entity." Satisfied with the explanation, Okin approved the lower margin rate.

36. Prior to that, on January 14, 2002, a CIBC Managing Director wrote Okin about how the aggressive market timing trading by Sassano's customers was harming the CIBC name. Addressing a particularly aggressive Sassano market timing customer that had over 30 accounts, the CIBC Managing Director told Okin: "[I]t appears this particular client trades aggressively and uses small size to stay under the radar of the mutual funds." Okin did nothing to stop this trading.

37. In addition, Sassano used the MFES electronic trading platform to break up trades into smaller dollar volumes within the same accounts. On September 24, 2002, Abry's Assistant Branch Manager sent Abry a "confidential" email of "high importance" entitled "Sassano Mutual Fund Trades," which warned:

I think we are going to have a potential problem with the way Mike's group has been processing trades for some accounts. In an effort to draw less attention to the timing issue, Mikes [sic] group is placing several exchanges in small amounts in an attempt to go unnoticed. So basically, where once you had 2 transactions an exchange out and an exchange in, now we have 20 in smaller increments.

While it may work in the short term, one account, 033-57873, generated almost 1,900 trades in August, on an exception run that both Compliance and our regulators look at when they perform an audit.

I'm not sure that they are doing anything illegal, but I would think once the fund families catch on they will be pissed. Should we get [the Head of Financial Services] involved to see what the potential issues to the firm could be?

38. Despite this warning, Abry did nothing to stop this abusive practice.

**Use of Schwab and Fidelity Accounts to Conceal Customers' Trades and Continue Timing Funds that Blocked Trading**

39. Sassano and Baruh also used platforms at other broker-dealers as a way to deceive mutual funds. Specifically, Sassano and Baruh opened accounts at Fidelity and Schwab on behalf of Sassano's market timing customers as another means of evading mutual fund blocks. Okin and Abry approved the opening of these accounts at Schwab and Fidelity knowing they were going to use them to continue timing funds that had previously blocked or rejected Sassano's customers' trades.

40. For example, on November 8, 2001, Mutual Fund Company D emailed World Markets' Head of Mutual Fund Marketing, complaining that it had:

noticed some market timing coming in through Schwab's RIA platform in Mutual European (\$3.7 million came in on Nov 5 and left 2 days later). After digging further with Schwab, we discovered that the broker of record was Mr. Sassano.

We wanted to make you aware that:

- 1) he's still timing assets in our funds despite our repeated requests to curb his activity, and
- 2) he is doing business away from CIBC and going through Schwab.

Mutual Fund Company D went on to threaten that "if his timing activity . . . is allowed to continue, we will have no choice but to suspend marketing support for any calendar quarter in which we discover future [timing] activity."

41. That email was forwarded to the Head of Financial Services, who, in turn, forwarded it to Okin. In doing so, the Head of Financial Services noted that because the President of Mutual Fund Company D was involved and that Mutual Fund Company D was a "strategic

partner," he had instructed Sassano "to stop using" the mutual fund. The Head of Financial Services also noted that Mutual Fund Company D's email "proves that the Schwab account isn't as concealing as we think." Okin responded simply by noting that he had forwarded the email chain on to Abry.

42. In a separate email concerning this incident, dated November 9, 2001, Okin noted to Abry that "this is where we can get into problems." Abry responded "so much for stealth trading." After Okin reminded Abry that the mutual fund was "one of our key relationships," Abry indicated he would make sure that Sassano and his team "understand."

43. Despite these warnings, Sassano continued to use Schwab and Fidelity accounts to market time mutual funds. For example, on February 4, 2002, Mutual Fund Company E blocked 13 Sassano accounts due to market timing. The Head of Mutual Fund Services forwarded this notification to the Head of Financial Services and Abry, telling them:

Fyi; this is the kind of email that we are getting on a much more regular basis. they are usually followed in about a month (from the originating company) with another email stating that new accounts have been identified from the same broker or that trading activity is now being detected through Schwab accounts. Then come the emails threatening to close us down as a firm.

44. Similarly, on February 11, 2002, Mutual Fund Company F requested no more trading, complaining that, although on January 3, 2002 it had identified 6 different rep numbers trading "hot money" through both World Markets and Schwab accounts, the timing had continued under 2 new rep numbers (bringing the total to 8). Okin, in forwarding the entire chain to Abry, wrote: "Scott, we have to be careful here. It is not prudent to screw around with our fund relationships to the point where they kick us out."

#### **Using Annuities to Market Time**

45. Sassano also used annuities as another vehicle in which to market time mutual funds.<sup>1</sup> To use variable annuities to time mutual funds, however, Sassano's group often had to evade the restrictions on market timing that the variable annuity companies had in place. For example, in an October 2001 email relaying that they had successfully stayed off the timing reports

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<sup>1</sup> Variable annuities are issued by insurance companies and include certain insurance features, such as a right to receive annuity payments at a time usually delayed until the future and the right to pass the contract value to a beneficiary upon death. Variable annuities are frequently sold as alternatives to direct investments in mutual funds, but in addition to charges for managing the mutual funds, customers are charged separate fees for the insurance features. Like mutual funds, the return of variable annuities varies with the market's performance, and variable annuities offer investors a selection of mutual funds in which to invest (the separate accounts). The investor may allocate his or her investment among the mutual funds available through the variable annuity.

of one particular annuity company, Sassano exhorted his team to "stay on top of why and how to keep under the radar [and] don't get lazy penetrate more."

46. Abry as well as other branch management was fully aware that Sassano used annuities as an additional platform in which to engage in market timing, and that variable annuity companies, like mutual funds, prohibited it. As Abry's Assistant Branch Manager wrote in a February 25, 2003 email to the Head of National Sales Practices at World Markets, "the annuities are another way for their market timers to get mutual fund capacity. They are also subject to the same trading restrictions a mutual fund would place on any other market timer that they thought was putting through excessive trades. From time to time we receive notice from the annuity that if the trading does not stop, our client will get kicked out."

47. Okin approved Sassano's use of annuities as another vehicle in which to market time mutual funds. Specifically, in June 2002, the Head of Oppenheimer Life Agency at World Markets received numerous complaints from annuity companies about Sassano's customers' market timing. Alarmed by this, she complained to her boss and asked that Sassano be stopped from permitting his customers' to time through annuities. She, however, was overruled. Specifically, at a July 2002 meeting, Okin approved Sassano's market timing of annuities, provided Sassano's customers did not time through annuities issued by certain favored annuity companies.

#### **D. VIOLATIONS**

48. As a result of the conduct described above, Sassano and Baruh willfully violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities, and 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. As part of their scheme to defraud mutual funds, Sassano and/or Baruh utilized numerous deceptive practices on behalf of their market timing hedge fund customers. These included routinely accepting mutual fund orders after 4:00 p.m. ET with the understanding that those trades would be presented to the mutual funds for processing as if they had been received by World Markets before 4:00 p.m., and therefore would receive that day's NAV; using new account numbers for blocked customer accounts; creating new RR numbers to disguise timers and their RRs from mutual funds; trading in smaller amounts to not be detected as timers by mutual funds, including using an in-house electronic trading platform to break up trades into small dollar volumes; using annuities to market time; using other broker-dealers that had other trading platforms, such as Schwab and Fidelity, to continue market timing mutual funds that had blocked their customers' trading; and in at least one instance, sending trades from a different branch to deceive the mutual funds about the origins of the trade. Through these actions, Sassano and Baruh willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

49. As a result of the conduct described above, Sassano and Baruh willfully aided and abetted and caused their customers' violations of Section 17(a) of the Securities Act, 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. Sassano's and Baruh's market timing customers engaged in

a fraudulent scheme to conceal their identities from the mutual fund companies' internal market timing monitors and by late trading. Customers consulted with Sassano and Baruh and authorized deceptive market timing and late trading. Sassano and Baruh knew that mutual funds were attempting to block their customers' trading by virtue of the block notices Sassano and Baruh received, and Sassano and Baruh knew that their timing customers were using multiple accounts and multiple RR numbers as part of this improper scheme. Sassano urged his customers to market time through annuities and trade in such a way as to "stay under the radar" of the annuity companies' internal market timing monitors. In addition, Baruh entered late trades on behalf of at least one customer while knowing the customer's trading decisions were occurring after market hours. Additionally, Baruh recommended to one customer that it create additional accounts so it could better market time mutual funds. As a result, that customer had multiple accounts at World Markets and Fahnestock. Similarly, Baruh recommended to another market timing customer that it evade the trading restrictions placed upon its accounts by purchasing that mutual fund in accounts that had never purchased the mutual fund before. Sassano and Baruh also substantially assisted their timing customers in carrying out the scheme. As noted above, Baruh entered late trades on behalf of their customer. In addition, Sassano and Baruh requested multiple RR numbers and multiple accounts, and routinely executed trades in funds that had imposed restrictions on marketing timing trading. Thus, Sassano and Baruh knowingly and substantially assisted their timing customers' fraudulent, deceptive scheme.

50. As a result of the conduct described above, Sassano and Baruh willfully aided and abetted and caused CIBC World Markets Corp.'s violations of Section 15(c) of the Exchange Act, which prohibits a broker or a dealer from effecting any transaction in, or inducing or attempting to induce the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance, and Rule 10b-3, which prohibits a broker or dealer from using or employing any act, practice, or course of business that is a manipulative, deceptive, or other fraudulent device or contrivance in connection with the purchase or sale of any security otherwise than on a national securities exchange. World Markets committed primary violations of Section 15(c) of the Exchange Act and Rule 10b-3. World Markets effectuated transactions in the purchase or sale of securities using fraudulent devices to hide its customers' market timing and late trading of mutual funds. Sassano and Baruh aided and abetted and caused World Markets' violations of Section 15(c) of the Exchange Act and Rule 10b-3, since they knowingly engaged in deceptive market timing and, in the case of Baruh late trading, on behalf of their customers. And since that conduct substantially assisted and caused World Markets to violate Section 15(c) and Rule 10b-3, by causing it to employ a manipulative, deceptive, or other fraudulent device in connection with the purchase or sale of a security, Sassano and Baruh aided and abetted and caused World Markets' violations of Section 15(c) Exchange Act and Rule 10b-3.

51. Baruh also willfully aided and abetted and caused World Markets' violations of Rule 22c-1. As an initial matter, World Markets violated Rule 22c-1. Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act, requires certain mutual funds, persons designated in such issuers' prospectuses as authorized to consummate transactions in any such securities, their principal underwriters, or dealers in the funds' securities to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. World Markets, by virtue of dealer agreements with mutual funds' principal underwriters,

was a dealer within the meaning of Rule 22c-1. World Markets accepted and executed trades after the close of the United States equity markets at a price other than the current NAV which was next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Baruh knew of, and substantially assisted in, this violation. Specifically, Baruh knowingly accepted mutual fund orders after 4:00 p.m. ET. Baruh then processed those orders as though they had been placed prior to 4:00 p.m. ET so the customer could receive the same day's NAV. Baruh's actions allowed the customer to place trades after 4:00 p.m., after learning after-hours information, but receive that same day's NAV. Baruh therefore willfully aided and abetted and caused World Markets' violations of Rule 22c-1 as adopted under Section 22(c) of the Investment Company Act.

52. As a result of the conduct described above, Okin and Abry willfully aided and abetted and caused violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(c) of the Exchange Act and Rules 10b-3 and 10b-5. Okin and Abry knew that Sassano and his group both had a large market timing business and were improperly concealing their activities from mutual funds, and they assisted them in doing so. More specifically, Okin and Abry received letters that mutual funds sent to World Markets informing it that the Sassano group's trading violated the respective fund's prospectus. Additionally, Okin and Abry were aware that at various times, certain mutual funds threatened to cancel their dealer agreements with World Markets because of Sassano's market timing. Okin and Abry also knew the Sassano group used deceptive tactics to evade the mutual fund's restrictions. For example, as discussed above, Okin and Abry knew Sassano used the Schwab trading platform to conceal his activities from the mutual funds and to continue to time mutual funds that had blocked Sassano's customers timing activity. Both were also aware of the allegations by at least one mutual fund that Sassano was breaking up trades and using multiple RR numbers "so the market timing goes undetected." Armed with this knowledge, Okin and Abry also provided substantial assistance. Okin and Abry, among others, helped the Sassano group gain access to the Schwab platform. Moreover, in June 2002, Okin approved a lower margin rate for one of Sassano's customers, despite Baruh specifically telling Okin that the customer had multiple accounts "to stay under the radar with the mutual fund companies, otherwise it is the same entity." Then, in July 2002, Okin approved Sassano's timing of annuities, over the objection of the Head of the Oppenheimer Life Agency, who by that time had received numerous complaints from annuity companies about Sassano's market timing. Finally, Abry knew Sassano used multiple accounts and broke up trades into small amounts to facilitate his deceptive market timing. Nonetheless, Abry approved multiple account opening documents for many of Sassano's market timing customers and knew of Sassano's frequent requests for additional RR numbers. As Baruh explained to Abry in one request for new RR numbers, "the reason for this is because the Sassano name is so well known in the mutual fund business that at times it becomes a hinderance. [sic] Therefore if we had new rep numbers, and to take it one step further, those reps still got paid out to Mike but had a special coding such as just his initials it would shield us from the Fund Companies." Consequently, Okin and Abry willfully aided and abetted and caused Sassano's and Baruh's and their customers' violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5, and World Markets' violations of Sections 10(b) and 15(c) of the Exchange Act and Rules 10b-3 and 10b-5.

53. Okin and Abry failed reasonably to supervise Sassano and Baruh. Abry, as branch manager at World Markets and Fahnestock, had immediate supervisory authority over Sassano and Baruh. Okin, as Head of PCS at World Markets, had supervisory authority for the RRs in PCS, including Sassano and Baruh. Okin retained this supervisory authority over Sassano and Baruh at Fahnestock. Okin and Abry, however, failed reasonably to supervise Sassano and Baruh. Okin and Abry were confronted with evidence that Sassano and Baruh were breaking up trades to evade mutual funds' internal timing monitors, using annuities as an additional way to obtain "capacity," using multiple RR numbers to evade detection and using external trading platforms to conceal trading activity. Despite their knowledge concerning Sassano's and Baruh's activities, neither took adequate steps to discipline Sassano or Baruh or otherwise took reasonable steps to stop this conduct, unless and until a mutual fund threatened to terminate its relationship with World Markets, and even then they did not take reasonable steps with a view to preventing the conduct. For these reasons, Okin and Abry failed reasonably to supervise Sassano and Baruh under Section 15(b)(6) of the Exchange Act, which incorporates by reference Section 15(b)(4)(E).

### III.

54. 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 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 Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203(i) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Baruh pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9(d) of the Investment Company Act; and

E. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Sassano 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 from causing violations and any future violations of Section 15(c) of the Exchange Act and Rule 10b-3, and whether Sassano should be ordered to pay disgorgement and prejudgment interest;

F. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 9(f) of the Investment Company Act, Baruh 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 from causing violations and any future violations of Rule 22c-1 as adopted under Section 22(c) of the Investment Company Act, and Section 15(c) of the Exchange Act and Rule 10b-3, and whether Baruh should be ordered to pay disgorgement and prejudgment interest; and

G. Whether, pursuant to Section 21C of the Exchange Act, Okin and Abry should be ordered to cease and desist from committing or causing violations of and any future violations of violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and from causing violations and any future violations of Section 15(c) of the Exchange Act and Rule 10b-3, and whether Okin and Abry should be ordered to pay disgorgement and prejudgment interest.

#### 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 each 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 any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that 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 forth with 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.

  
Nancy M. Morris  
Secretary

Chairman Cox and  
Commissioner Campos  
Not Participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 55209 / January 31, 2007

ADMINISTRATIVE PROCEEDING  
File No. 3-12555

In the Matter of

Marshall Dornfeld,

Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS,  
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 that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Marshall Dornfeld ("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 Proceedings, 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<sup>1</sup> that:

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<sup>1</sup> 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.

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## **Respondent**

1. Marshall Dornfeld, 43, resides in Quogue, New York. From 1994 to January 2003, Dornfeld was a Managing Director at CIBC World Markets Corp., serving as the Head of Financial Services. Among other responsibilities, Dornfeld supervised the Mutual Fund Services department and the Oppenheimer Life Agency at CIBC World Markets Corp. He holds Series 7 and 24 licenses.

## **Other Relevant Entity**

2. CIBC World Markets Corp. ("CIBC"), is a New York based broker-dealer subsidiary of Canadian Imperial Bank of Commerce, a Canadian financial and bank holding company. CIBC, through its CIBC Oppenheimer retail division, serviced high-net-worth individuals, money managers, and other customers, including hedge funds. In January 2003, CIBC sold its Oppenheimer retail division to another broker-dealer. During the relevant time period, CIBC was registered with the Commission as both a broker-dealer and an investment adviser.

## **Summary**

3. This matter involves Dornfeld's failure reasonably to supervise registered representatives ("brokers") of CIBC who engaged in an illegal market timing scheme on behalf of numerous CIBC customers.

4. Between 1999 and January 2003, the CIBC brokers defrauded hundreds of mutual funds and the funds' shareholders by utilizing deceptive practices to circumvent the mutual funds' restrictions on market timing. More specifically, mutual funds would reject market timing customers' trades, and notify CIBC and the brokers that this trading violated prohibitions set forth in the funds' prospectuses and harmed the funds' performance. In response, the brokers employed a variety of deceptive acts and practices to enable their customers to continue timing the same funds. These practices included misrepresenting the nature of the trades to the funds, opening numerous additional accounts on behalf of their customers to conceal the customers' identity from the funds, utilizing multiple registered representative identification numbers to hide their own identity, and entering trades in amounts that would avoid the funds' market timing detection triggers. Through these activities, the brokers violated, among other provisions, Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted violations of 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5.

5. Dornfeld failed reasonably to supervise the brokers with a view to preventing their violations of the federal securities laws. Dornfeld supervised the mutual fund marketing and annuity groups at CIBC, which were responsible for obtaining dealer-agreements with underwriters for mutual funds and annuity companies, respectively. Dornfeld thus had responsibility for supervising CIBC's relationships with mutual funds and annuities. The dealer-agreements provided notice that CIBC's brokers were to sell the mutual fund and annuity products in conformity with the terms of the products' prospectuses and in conformity with the

federal securities laws. At the same time, Dornfeld was informed repeatedly of the CIBC's brokers' efforts to deceive mutual funds in order to facilitate market timing. Despite being alerted that both mutual funds and annuity companies objected to the brokers' deceptive market timing practices, and being told that the brokers' customers' trading violated the terms of the products' prospectuses, Dornfeld failed reasonably to respond with a view to preventing the brokers' deceptive market timing activity. Dornfeld, therefore, failed reasonably to supervise the brokers.

#### **CIBC's Brokers Utilized Deceptive Trading Practices**

6. A broker at CIBC, as well as a number of other brokers who worked in his group, had a large, successful market timing business in which they executed mutual fund orders on behalf of their customers, including market timing hedge funds. CIBC and the brokers' market timing group received over 1000 letters and emails from mutual funds regarding the brokers' customers' market timing trading activities. These letters and emails indicated that the brokers' customers' market timing trading violated prohibitions on trading set forth in the funds' prospectuses and harmed the funds' performance, and therefore the funds were rejecting the brokers' customers' trades. The brokers repeatedly ignored these letters and emails. Instead, the brokers worked with their customers to implement their market timing strategies up until the point when mutual funds threatened to terminate their relationship with CIBC. Even then, the brokers did not always stop, resulting in a number of mutual funds terminating their dealer-agreements with CIBC or refusing to accept any trades from the branch office to which the brokers were assigned.

7. Among the deceptive practices that the brokers utilized on behalf of their customers were the following: (1) creating new accounts for blocked customer accounts; (2) creating new registered representative identification numbers to disguise timers and their brokers from mutual funds; (3) trading in smaller amounts in order to avoid detection by mutual funds; (4) using annuities to market time; and (5) using other broker-dealer firms that had other trading platforms, such as Charles Schwab & Co., Inc. ("Schwab") and FMR Corp. ("Fidelity"), to continue market timing mutual funds that had blocked their customers' trading through CIBC.

8. As a result of the conduct described above, the brokers violated, among other provisions, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5.

#### **Dornfeld Failed Reasonably to Supervise the CIBC Brokers**

9. As the Head of Financial Services at CIBC, Dornfeld supervised the mutual fund marketing and annuity groups at CIBC, which were responsible, respectively, for obtaining dealer agreements with mutual funds and annuity companies. The dealer-agreements generally required CIBC to sell the mutual fund and annuity products in conformity with the terms of the products' prospectuses and the securities laws.

10. During the course of his duties, Dornfeld became aware that the brokers were using deceptive market timing techniques. Dornfeld saw "kick out" letters from mutual funds and annuity companies indicating that the brokers' trading practices violated the terms of mutual funds' and annuity companies' prospectuses. Dornfeld was also repeatedly alerted that both mutual funds and annuity companies objected to the brokers' abusive market timing practices. Dornfeld also knew that the brokers were using Schwab and Fidelity accounts to continue market timing mutual funds that had blocked their customers' trading through CIBC. For example, after learning that one mutual fund had detected the brokers' market timing trades through Schwab accounts, Dornfeld emailed the Head of Private Client Services, telling him that the fund's discovery "proves that the Schwab account isn't as concealing as we think." Despite this, Dornfeld did nothing to stop the brokers' market timing activities until a mutual fund or annuity company threatened to (or in fact did) terminate its relationship with CIBC. Only then would Dornfeld exercise his power to stop the brokers' abusive market timing of that mutual fund.

11. For example, after a mutual fund objected to the brokers' timing on behalf of a customer through CIBC, the brokers directed the customer's market timing through Schwab. The same mutual fund, however, then detected market timing through Schwab and determined that the trading was done by the CIBC brokers and their customer. The mutual fund then emailed CIBC about its discovery and threatened to terminate its marketing relationship with CIBC if the brokers' "timing activity with [that particular fund] is allowed to continue." Dornfeld received this email. Only upon reading the mutual fund's threat to terminate its marketing relationship with CIBC did Dornfeld direct the brokers to stop timing that particular fund.

12. Dornfeld was also aware that, at the brokers' request, CIBC established numerous selling agreements with underwriters for mutual fund families that previously had no relationship with CIBC. The mutual fund marketing area that Dornfeld supervised was responsible for obtaining these agreements. Dornfeld understood that the brokers wanted these agreements so that his team's customers could then time these funds. Despite this understanding, in some of the selling agreements, CIBC made representations that its brokers did not provide market timing services to its customers. Dornfeld approved those agreements.

13. For example, in the agreement allowing CIBC to sell one particular fund, when asked "does your firm employ market timing services or utilize a market timing strategy," CIBC responded "No." That response was false. Despite this, Dornfeld approved CIBC' dealer-agreement with that particular mutual fund underwriter.

14. The brokers also market timed mutual funds through variable annuities. Hedge funds and other customers purchased variable annuities to market time the underlying mutual fund portfolios. Assets invested through variable annuities are used to purchase securities, including mutual funds. In general, the annuity contracts allow the contract owner to place securities orders with the variable insurance company. These orders are then aggregated and transmitted to the mutual fund complex on a net basis. Because issuers of variable annuities aggregate trades in their contracted fund complexes and transmit the trades on a net basis, trading through variable annuity contracts can hide the identity of timers, facilitating their timing activity.

15. Dornfeld's subordinate from the Oppenheimer Life Agency told him that the brokers' deceptive timing through annuities was straining relationships with the annuity companies. Indeed, Dornfeld's subordinate requested that, in light of the annuity companies' complaints, Dornfeld stop the brokers from timing through annuities. Dornfeld, however, refused her request. Rather, he approved the brokers market timing of annuities, provided the brokers did not time through annuities issued by the top seven annuity companies with which CIBC did business -- so as not to harm CIBC's relationships with those firms.

16. If Dornfeld had responded reasonably to the red flags reflecting the CIBC brokers' conduct, he could have detected and prevented the brokers' securities law violations. As a result of the conduct described above, Dornfeld failed reasonably to supervise the brokers with a view to preventing their violations of the federal securities laws.

#### **Failure to Supervise**

17. Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer who "has failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to his supervision." Section 15(b)(6)(A)(i) incorporates by reference Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker or dealer.

18. As a result of the conduct described above, Dornfeld failed reasonably to supervise the brokers with a view to preventing their violations of the federal securities laws.

19. Although Dornfeld was not a line supervisor for the brokers, the Commission has recognized that a non-line supervisor can be charged with failure to supervise when the non-line supervisor had the power to control the conduct at issue, was aware of red flags of the RR's conduct, and unreasonably failed to take action. In the Matter of John H. Gutfreund, 51 S.E.C. 93, 1992 WL 362753.

20. Here, Dornfeld oversaw mutual fund marketing and annuities. His subordinates frequently told Dornfeld that the brokers were deceptively market timing mutual funds, in violation of the mutual funds' and variable annuity companies' prospectuses, thus causing CIBC to breach its dealer-agreement with the underwriters for these companies. Moreover, these deceptive tactics violated the federal securities laws. Dornfeld, however, did not take reasonable steps to stop this conduct. Because of his power and responsibilities, Dornfeld "was uniquely positioned to exercise effective supervisory control in the specialized area of mutual fund sales," yet failed to do so when presented with red flags of potential violations. In the Matter of Robert J. Check, 49 S.E.C. 1004, 1988 WL 902613 at \*4 (holding that Check, the manager of the mutual funds for Advest, Inc. failed to exercise reasonable supervision over salesmen with a view to preventing their failure to grant customer mutual fund breakpoints, despite the fact that Check, who was aware of red flags, was a non-line supervisor and that others were also responsible for ensuring that salesmen complied with applicable breakpoint requirements). Consequently, Dornfeld failed reasonably to supervise the brokers under Section 15(b)(6) of the Exchange Act, which incorporates by reference Section 15(b)(4)(E).

## Undertakings

21. Ongoing Cooperation by Dornfeld. Dornfeld undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Dornfeld has undertaken:

A. To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff;

B. To be interviewed by the Commission's staff at such times as the staff reasonably may request and to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

C. That in connection with any testimony of Dornfeld to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Dornfeld:

- i. Agrees that any such notice or subpoena for his appearance and testimony may be served by regular mail on his counsel, Theodore Snyder, Krebsbach & Snyder, One Exchange Plaza, 55 Broadway, Ste. 1600, New York, NY 10006; and
- ii. Agrees that any such notice or subpoena for his appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure or the Commission's Rules of Practice.

## IV.

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

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that:


A. Respondent be, and hereby is, suspended from association in a supervisory capacity with any broker or dealer for a period of 12 months, effective on the second Monday following the entry of this Order.

B. IT IS FURTHERED ORDERED that Respondent shall, within 30 days of the entry of this Order, pay disgorgement of \$1, and a civil money penalty in the amount of \$100,000 to the Securities and Exchange Commission. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial

Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Dornfeld as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helene Glotzer, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, New York, NY 10281.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("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 he shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that he is entitled to, nor shall he further benefit by offset or reduction 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.

  
Nancy M. Morris  
Secretary