SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for October 2008, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

42 Documents

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 58711/ October 1, 2008

ORDER EXTENDING EMERGENCY ORDER PURSUANT TO SECTION 12(k)(2) OF THE SECURITIES EXCHANGE ACT OF 1934 TAKING TEMPORARY ACTION TO RESPOND TO MARKET DEVELOPMENTS

Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] on September 17, 2008, the Securities and Exchange Commission ("Commission") issued an Emergency Order (the "Order") aimed at further reducing fails to deliver and addressing potentially abusive "naked" short selling in all equity securities.[2] The Order became effective at 12:01 a.m. E.D.T. on September 18, 2008 and is currently set to terminate at 11:59 p.m. E.D.T. on October 1, 2008.

Pursuant to our authority under Section 12(k)(2)(C) of the Exchange Act, we are extending the Order. Section 12(k)(2)(C) authorizes the Commission to extend an emergency order issued pursuant to Section 12(k)(2)(A) of the Exchange Act for a total effective period of up to 30 calendar days, if the Commission finds that the emergency still exists and determines that an extension is necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets.

We have carefully reevaluated the current state of the markets and we remain concerned about the potential of sudden and excessive fluctuations of securities prices generally and disruption in the functioning of the securities markets that could threaten fair and orderly markets. We intend the enhanced delivery requirements (temporary Rule

[1] 15 USC 78l(k)(2).

[2] See Securities Exchange Act Release No. 58572 (Sept. 17, 2008)

204T and elimination of the options market maker exception) imposed by the Order and the "naked" short selling antifraud rule to provide powerful disincentives to those who might otherwise exacerbate artificial price movements through "naked" short selling. Thus, we have determined in this environment that the standards under Section 12(k)(2) for extending the Order have been met. Accordingly, we have determined that extending the Order is in the public interest and necessary to maintain fair and orderly securities markets and for the protection of investors.

In addition, we note that Staff of the Division of Trading and Markets has issued guidance regarding the Order to address current and anticipated technical and operational concerns resulting from the requirements of the Order.[3] The guidance will continue to apply for the duration of the Order and the Commission hereby incorporates and adopts the guidance.

IT IS THEREFORE ORDERED that, pursuant to Section 12(k)(2)(C) of the Exchange Act, the Commission hereby incorporates and adopts the Division of Trading and Markets: Guidance Regarding the Commission's Emergency Order Concerning Rules to Protect Investors Against "Naked" Short Selling Abuses and the Division of Trading and Markets Guidance Regarding Sale of Loaned but Recalled Securities.

[3] See http://www.sec.gov/divisions/marketreg/204tfaq.htm and http://www.sec.gov/divisions/marketreg/loanedsecuritiesfaq.htm

IT IS FURTHER ORDERED that, pursuant to Section 12(k)(2)(C) of the Exchange Act, the Order is extended such that it will terminate at 11:59 p.m. E.D.T. on Friday, October 17, 2008.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 58703 / October 1, 2008

ORDER EXTENDING EMERGENCY ORDER PURSUANT TO SECTION 12(k)(2) OF THE SECURITIES EXCHANGE ACT OF 1934 TAKING TEMPORARY ACTION TO RESPOND TO MARKET DEVELOPMENTS

On September 18, 2008, the Commission issued an Emergency Order pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 ("Exchange Act") (the "Order") temporarily broadening Exchange Act Rule 10b-18's safe harbor from liability for issuer repurchases in order to facilitate orderly markets.[1] That Order became effective at 12:01 a.m. E.D.T. on September 19, 2008, and is currently set to terminate at 11:59 p.m. E.D.T. on October 2, 2008.

Pursuant to our authority under Section 12(k)(2)(C) of the Exchange Act, we are extending the Order. Section 12(k)(2)(C) authorizes the Commission to extend an emergency order issued pursuant to Section 12(k)(2)(A) of the Exchange Act for a total effective period of up to 30 calendar days, if the Commission finds that the emergency still exists and determines that an extension is necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets.

We have carefully reevaluated the current state of the markets and we remain concerned about the potential of sudden and excessive fluctuations of securities prices generally and disruption in the functioning of the securities markets that could threaten fair and orderly markets. Issuer repurchases can represent an important source of liquidity during these times of market volatility. Thus, we have determined in this environment that the standards under Section 12(k)(2) for extending the Order have been met. Accordingly, the Commission has determined that extending

[1] Exchange Act Release No. 58588 (Sept. 18, 2008).

the Order is in the public interest and necessary to maintain fair and orderly securities markets and for the protection of investors.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k)(2)(C) of the Exchange Act, that the Order is extended such that it will terminate at 11:59 p.m. E.D.T. on Friday, October 17, 2008.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-28431; 812-13540]

Eaton Vance Floating-Rate Income Trust, et al.; Notice of Application

October 2, 2008

Agency: Securities and Exchange Commission ("Commission").

Action: Notice of application for an order under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from sections 18(a)(1)(A) and (B) of the Act.

Applicants: Eaton Vance Floating-Rate Income Trust, Eaton Vance Senior Floating-Rate Trust, Eaton Vance Senior Income Trust, Eaton Vance Credit Opportunities Fund, and Eaton Vance Limited Duration Income Fund (each, a "Fund" and collectively, "Funds").

Summary of Application: Applicants request an order ("Order") granting an exemption from sections 18(a)(1)(A) and (B) of the Act for a two-year period immediately following the date of the Order. The Order would permit each Fund to issue debt securities subject to asset coverage of 200% that would be used to refinance all of the Fund's issued and outstanding auction preferred shares ("APS Shares"). The Order also would permit each Fund to declare dividends or any other distributions on, or purchase, capital stock during the term of the Order, provided that any class of senior securities representing indebtedness has asset coverage of at least 200% after deducting the amount of such transaction.

Filing Dates: The application was filed on June 10, 2008, and amended on July 2, 2008, July 29, 2008, and September 2, 2008.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the

Commission's Secretary, and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 pm on October 22, 2008, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: c/o Frederick S. Marius, Chief Legal Officer, Eaton Vance Management, 255 State Street, Boston, MA 02109.

For Further Information Contact: Courtney S. Thornton, Senior Counsel, at (202) 551-6812, or Janet M. Grossnickle, Assistant Director, at (202) 942-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application may be obtained for a fee at the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1520 (tel. 202-551-5850).

Applicants' Representations:

1. Each of the Funds is organized as a Massachusetts business trust and is a closed-end management investment company registered under the Act. Each Fund is advised by Eaton Vance Management ("Eaton Vance") and has issued and outstanding a class of common shares and a class of one or more series of APS Shares.

2. Applicants state that the Funds issued their outstanding APS Shares for purposes of investment leverage to augment the amount of investment capital available for use in the pursuit of their investment objectives. Applicants state that, through the use of leverage, the

Funds seek to enhance the investment return available to the holders of their common shares by earning a rate of portfolio return (which includes the return obtained from securities purchased from the proceeds of APS Share offerings) that exceeds the dividend rate that the Funds pay to holders of the APS Shares. Applicants represent that APS shareholders are entitled to receive a stated liquidation preference amount of $25,000 per share (plus any accumulated but unpaid dividends) in any liquidation, dissolution, or winding up of the relevant Fund before any distribution or payment to holders of the Fund's common shares. They state that dividends declared and payable on APS Shares have a similar priority over dividends declared and payable on the Funds' common shares. In addition, applicants state that APS Shares are "perpetual" securities and are not subject to mandatory redemption by a Fund (provided certain asset coverage tests are met). Further, applicants state that APS Shares are redeemable at each Fund's option.

3. Applicants state that prior to February 2008, dividend rates on the APS Shares for each dividend period were set at the market clearing rate determined through an auction process that brought together bidders, who sought to buy APS Shares, and holders of APS Shares, who sought to sell their APS Shares. Applicants explain that their by-laws provide that if an auction fails to clear (because of an imbalance of sell orders over bids), the dividend payment rate over the next dividend period is set at a specified maximum applicable rate (the "Maximum Rate") determined by reference to a short-term market interest rate (such as LIBOR or a commercial paper rate). Applicants state that an unsuccessful auction is not a default; the relevant Applicant continues to pay dividends to all holders of APS Shares, but at the specified Maximum Rate rather than a market clearing rate.

4. Applicants state that if investors did not purchase all of the APS Shares tendered for sale at an auction, dealers historically would enter into the auction and purchase any excess shares to prevent the auction from failing. Applicants represent that this auction mechanism generally provided readily available liquidity to holders of APS Shares for almost twenty years. Applicants believe that many investors invested short-term cash balances in APS Shares believing they were safe short-term investments and, in many cases, the equivalent of cash.

5. Applicants state that in February 2008, the financial institutions that historically provided "back stop" liquidity to APS Share auctions stopped participating in them and the auctions began to fail. Applicants state that beginning on February 13, 2008, all closed-end funds advised by Eaton Vance that had outstanding APS Shares (including the Funds) experienced auction failures due to an imbalance between buy and sell orders. Applicants also state that there is no established secondary market that would provide holders of APS Shares with the liquidation preference of $25,000 per share. Applicants state that four of the five Funds to date have redeemed approximately two-thirds of their APS Shares with borrowings from a commercial paper conduit facility, but have been prohibited from redeeming their remaining APS Shares because, among other reasons, they would not have the 300% asset coverage required by section 18(a)(1) of the Act after a full redemption of the APS Shares. As a result, applicants state that there is currently no reliable mechanism for holders of APS Shares to obtain liquidity, and believe that, industry-wide, the current lack of liquidity is causing distress for a substantial number of APS shareholders and creating severe hardship for many investors.

6. Applicants seek relief for a period of two years to facilitate temporary borrowings by the Funds that would enhance their ability to provide a liquidity solution to the holders of

their APS Shares in the near term[1] while they seek a more permanent form of replacement leverage.[2] Because of the limited availability of debt financing in the current, severely constrained capital markets, the applicants believe that the negotiation, execution and closing of a borrowing transaction to replace the leverage currently represented by the APS Shares, if it can be effected, might take several months following the issuance of the Order. Once the debt incurred in replacement of the APS Shares is in place, it is uncertain whether and when the applicants will be able to issue LPP Shares to replace the debt, or how quickly the securities and capital markets will return to conditions that would enable the applicants to achieve compliance with the asset coverage requirements that would apply in the absence of the Order through some other means. In light of these factors, and given the continuing unsettled state of the securities and capital markets, which makes it impossible to establish a precise schedule for consummating capital markets transactions, the applicants believe that a two-year exemption period is reasonable and appropriate. Each Fund's refinancing of APS Shares would be subject to the Fund obtaining any necessary approval of changes to the Fund's fundamental investment policies and approval of the refinancing arrangements by the Fund's board of trustees ("Board").

Applicants' Legal Analysis:

1. Section 18(a)(1)(A) of the Act provides that it is unlawful for any registered closed-end investment company to issue any class of senior security representing indebtedness, or to sell such security of which it is the issuer, unless the class of senior security will have an asset coverage of at least 300% immediately after issuance or sale. Section 18(a)(2)(A) of the

[1] Applicants note that the cost of the replacement leverage is expected, over time, to be lower than the total cost of APS Shares based on the Maximum Rates applicable to the APS Shares of those Funds.

[2] Eaton Vance and its affiliates, including the Funds, have recently obtained no-action relief from the Commission staff in connection with Liquidity Protected Preferred Shares ("LPP Shares"), a new type of preferred stock that the Funds potentially would issue to supplement or replace the existing APS Shares. See Eaton Vance Management, SEC No-Action Letter (June 13, 2008).

Act provides that it is unlawful for any registered closed-end investment company to issue any class of senior security that is a stock, or to sell any such security of which it is the issuer, unless the class of senior security will have an asset coverage of at least 200% immediately after such issuance or sale.[3]

2. Section 18(a)(1)(B) prohibits a closed-end fund from declaring a dividend or other distribution on, or purchasing, its own capital stock unless its outstanding indebtedness will have an asset coverage of at least 300% immediately after deducting the amount of such dividend, distribution or purchase price.[4] Section 18(a)(2)(B) prohibits a closed-end fund from declaring a dividend or other distribution on, or purchasing, its own common stock unless its outstanding preferred stock will have an asset coverage of at least 200% immediately after deducting the amount of such dividend, distribution or purchase price.

3. Section 6(c) of the Act provides, in relevant part, that the Commission, by order upon application, may conditionally or unconditionally exempt any person, security, or transaction from any provision of the Act if and to the extent necessary or 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.

4. Applicants request that the Commission issue an Order under section 6(c) of the Act to exempt each Fund from the 300% asset coverage requirements set forth in sections

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[3] Section 18(h) of the Act defines asset coverage of a senior security representing indebtedness of an issuer as the ratio which the value of the total assets of the issuer, less all liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of senior securities representing indebtedness of the issuer. The section defines asset coverage of the preferred stock of an issuer as the ratio which the value of the total assets of the issuer, less all liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of senior securities representing indebtedness of the issuer plus the amount the class of senior security would be entitled to on involuntary liquidation.

[4] An exception is made for the declaration of a dividend on a class of preferred stock if the senior security representing indebtedness has an asset coverage of at least 200% at the time of declaration after deduction of the amount of such dividend. See section 18(a)(1)(B) of the Act.

18(a)(1)(A) and (B) of the Act. Specifically, the Funds seek relief from the section 18 asset coverage requirements for senior securities representing indebtedness for a period not to exceed two years from the date on which the requested Order is issued (the "Exemption Period") to permit the Funds to refinance any outstanding APS Shares issued prior to February 1, 2008 with debt so long as they have 200% asset coverage, rather than the 300% asset coverage that would ordinarily apply under section 18 to senior securities representing indebtedness, (a) when they incur that debt, and (b) when they declare dividends or any other distributions on, or purchase, their capital stock, after deduction of the amount of such dividend, distribution or purchase price. Applicants state that, except as permitted under the requested Order, if issued, the Funds would meet all of the asset coverage requirements of section 18(a) of the Act. In addition, applicants state that each Fund that borrows in reliance on the Order will either pay down or refinance the debt within the Exemption Period so that the Fund would, at the expiration of the Exemption Period and thereafter, comply with the applicable asset coverage requirements (200% for equity or 300% for debt) under section 18 of the Act.

5. Applicants state that section 18 reflects congressional concerns regarding preferential treatment for certain classes of shareholders, complex capital structures, and the use of excessive leverage. Applicants submit that another concern was that senior securities gave the misleading impression of safety from risk. Applicants believe that the request for temporary relief is necessary, appropriate and in the public interest and that such relief is consistent with the protection of investors and the purposes intended by the policy and provisions of section 18.

6. Applicants note that the illiquidity of APS Shares is a unique, exigent situation that is posing urgent, and in some cases devastating, hardships on APS shareholders. Applicants represent that the proposed replacement of the APS Shares with debt would provide liquidity for

the Funds' APS shareholders while the Funds continue their efforts to obtain a more permanent form of financing (such as through the issuance of LPP Shares) that fully complies with the asset coverage requirements of section 18.[5]

7. Applicants state that the requested Order would permit the Funds to continue to provide their common shareholders with the enhanced returns that leverage may provide. Applicants also represent that the Order would help avoid the potential harm to common shareholders that could result if the Funds were to deleverage their portfolios in the current difficult market environment[6] or that could result if a reduction in investment return reduced the market price of common shares.

8. Applicants believe that the interests of both classes of the Funds' current investors would be well served by the requested order – the APS shareholders because they would achieve the liquidity that the market currently cannot provide (as well as full recovery of the liquidation value of their shares) and the common shareholders because the cost of the new form of leverage would, over time, be lower than that of the total cost of the APS Shares based on their Maximum Rates and the adverse consequences of deleveraging would be avoided.

9. Applicants represent that the proposed borrowing would be obtained from banks, insurance companies or qualified institutional buyers (as defined in Rule 144(a)(1) under the Securities Act of 1933) who would be capable of assessing the risk associated with the transaction. Applicants also state that, to the extent the Act's asset coverage requirements were aimed at limiting leverage because of its potential to magnify losses as well as gains, they

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[5] See supra note 2.

[6] Applicants state that the bulk of each Fund's portfolio is in floating rate senior secured loans. Applicants believe that it is difficult to sell such loans at par value in the current market because of market makers' own impaired capital positions. Applicants expect, however, that the loans generally will be repaid in full as they come due. Applicants thus believe it would be disadvantageous to sell the loans at less than par into the current market.

believe that the proposal would not unduly increase the speculative nature of the Funds' common shares because the relief is temporary and the Funds would be no more highly leveraged if they replace the existing APS Shares with borrowing.[7] Applicants also state that the proposed liquidity solution would not make the Funds' capital structure more complex, opaque, or hard to understand or result in pyramiding or inequitable distribution of control.

10. Applicants state that the current state of the credit markets, which has affected the APS Shares, is an historic event of unusual severity, which requires a creative and flexible response on the part of both the public and private sectors. Applicants believe that these issues have created an urgent need for limited, quick, thoughtful and responsive solutions. Applicants believe that the request meets the standards for exemption under section 6(c) of the Act.

Applicants' Conditions:

Applicants agree that any order granting the requested relief shall be subject to the following conditions:

1. Each Fund that borrows subject to 200% asset coverage under the order will do so only if such Fund's Board, including a majority of the trustees who are not "interested persons" (as defined in section 2(a)(19) of the Act) ("Independent Trustees"), shall have determined that such borrowing is in the best interests of such Fund, its common shareholders, and its APS shareholders. Each Fund shall make and preserve for a period of not less than six years from the date of such determination, the first two years in an easily accessible place, minutes specifically describing the deliberations by the Board and the information and documents supporting those

[7] Applicants acknowledge that managing any portfolio that relies on borrowing for leverage entails the risk that, when the borrowing matures and must be repaid or refinanced, an economically attractive form of replacement leverage may not be available in the capital markets. For that reason, any portfolio that relies on borrowing for leverage is subject to the risk that it may have to deleverage, which could be disadvantageous to the portfolio's common shareholders. Applicants therefore state that they regard leveraging through borrowing as potentially a temporary, interim step, with the issuance of new preferred stock as a possible longer-term replacement source of portfolio leverage, such as LPP Shares.

deliberations, the factors considered by the Board in connection with such determination, and the basis of such determination.

2. Upon expiration of the Exemption Period, each Fund will have asset coverage of at least 300% for each class of senior security representing indebtedness.

3. The Board of any Fund that has borrowed in reliance on the order shall receive and review, no less frequently than quarterly during the Exemption Period, detailed progress reports prepared by management (or other parties selected by the Independent Trustees) regarding and assessing the efforts that the applicant has undertaken, and the progress that the applicant has made, towards achieving compliance with the appropriate asset coverage requirements under section 18 by the expiration of the Exemption Period. The Board, including a majority of the Independent Trustees, will make such adjustments as it deems necessary or appropriate to ensure that the applicant comes into compliance with section 18 of the Act within a reasonable period of time, not to exceed the expiration of the Exemption Period. Each Fund will make and preserve minutes describing these reports and the Board's review, including copies of such reports and all other information provided to or relied upon by the Board, for a period of not less than six years from the date of such determination, the first two years in an easily accessible place.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 58723 / October 2, 2008

ORDER EXTENDING EMERGENCY ORDER PURSUANT TO SECTION 12(k)(2) OF THE SECURITIES EXCHANGE ACT OF 1934 TAKING TEMPORARY ACTION TO RESPOND TO MARKET DEVELOPMENTS

Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] on September 18, 2008, the Securities and Exchange Commission ("Commission") issued an Emergency Order (the "Order") that prohibited persons from selling short the securities of financial institutions. The Order became effective at 12:01 a.m. E.D.T. on September 19, 2008 and is currently set to terminate at 11:59 p.m. E.D.T. on October 2, 2008.[2]

Pursuant to our authority under Section 12(k)(2)(C) of the Exchange Act, we are extending the Order. Section 12(k)(2)(C) authorizes the Commission to extend an emergency order issued pursuant to Section 12(k)(2)(A) of the Exchange Act for a total effective period of up to 30 calendar days, if the Commission finds that the emergency still exists and determines that an extension is necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets.

We have carefully reevaluated the current state of the markets and we remain concerned about the potential for sudden and excessive fluctuations of securities prices generally and disruption in the functioning of the securities markets that could threaten

[1] 15 USC 78l(k)(2).

[2] See Securities Exchange Act Release No. 58592 (Sept. 18, 2008); see also Securities Exchange Act Release No. 58611 (Sept. 21, 2008).

fair and orderly markets. We intend the prohibition to restore investor and market confidence by preventing short selling from being used to drive down the prices of securities in financial institutions even where there is no fundamental basis for a price decline other than general market conditions. Thus, we have determined in this environment that the standards under Section 12(k)(2) for extending the Order have been met. Accordingly, we have determined that extending the Order is in the public interest and necessary to maintain fair and orderly securities markets and for the protection of investors.

IT IS THEREFORE ORDERED that, pursuant to Section 12(k)(2)(C) of the Exchange Act, the Order is extended such that it will terminate at the earlier of (i) three business days from the President's signing of the Emergency Economic Stabilization Act of 2008 (H.R. 1424), or (ii) 11:59 p.m. E.D.T. on Friday, October 17, 2008.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 58724 / October 2, 2008

AMENDMENT TO ORDER AND ORDER EXTENDING EMERGENCY ORDER PURSUANT TO SECTION 12(k)(2) OF THE SECURITIES EXCHANGE ACT OF 1934 TAKING TEMPORARY ACTION TO RESPOND TO MARKET DEVELOPMENTS

Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] on September 18, 2008, the Securities and Exchange Commission ("Commission") issued an Emergency Order,[2] as amended on September 21, 2008 (the "Order"),[3] requiring institutional investment managers to report short sales of certain publicly traded securities. That Order took effect on September 22, 2008 and required the filing of a Form SH on September 29, 2008. The Order is currently set to terminate on October 2, 2008.

Pursuant to its authority under Section 12(k)(2)(C) of the Exchange Act, the Commission is extending the Order. Section 12(k)(2)(C) authorizes the Commission to extend an emergency order issued pursuant to Section 12(k)(2)(A) of the Exchange Act for a total effective period of up to 30 calendar days, if the Commission finds that the emergency still exists and determines that an extension is necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets. As a result of the extension, Forms SH shall be required to be filed on October 6, 2008 and

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1 15 USC 78l(k)(2).

2 See Exchange Act Release No. 58591 (September 18, 2008).

3 See Exchange Act Release No. 58591A (September 21, 2008).

October 14, 2008.[4] The Commission is also making technical amendments to Form SH and its accompanying Instructions.

The Commission continues to be concerned about the potential for sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. The Commission also continues to believe that some persons may take advantage of issuers that have become temporarily weakened by current market conditions to engage in inappropriate short selling in the securities of such issuers. Therefore, the Commission has concluded that it remains necessary to require certain institutional investment managers to report information concerning short sales of securities. Accordingly, the Commission has determined that extending the Order is necessary in the public interest and for the protection of investors to maintain fair and orderly securities markets.

The Commission believes that the nonpublic submission of Form SH may help prevent artificial volatility in securities as well as further downward swings that are caused by short selling, while at the same time, providing the Commission with useful information to combat market manipulation that threatens investors and capital markets. Also, the Commission has considered further the reasons to maintain the information as nonpublic in the current market environment, and is concerned that publicly available Form SH data could give rise to additional, imitative short selling that was not intended by the Commission's Order. Accordingly, the Commission has determined that Forms SH filed under the Order including those that were due on September 29, 2008 will

[4] These reports must be filed electronically using the Commission's EDGAR system.

remain nonpublic to the extent permitted by law without the filer needing to submit a confidential treatment request.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k)(2)(C) of the Exchange Act, that the Order is extended such that it will terminate at 11:59 p.m. EDT on Friday, October 17, 2008.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

OMB Number: 3235-0646

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM SH

FORM SH COVER PAGE

Report for the Period Ended: ______[Month, Day, Year]______

Check here if Amendment [ ]; Amendment Number: _____
This Amendment (Check only one): [ ] is a restatement.
[ ] adds new entries.

Institutional Investment Manager Filing this Report:

Name: ______________________________
Address: ______________________________
____
____

Form 13F File Number: 28-____________

The institutional investment manager filing this report and the person by whom it is signed hereby represent that the person signing the report is authorized to submit it, that all information contained herein is true, correct and complete, and [that] it is understood that all required items, statements, schedules, lists, and tables, are considered integral parts of this [for]m.

Person Signing this Report on Behalf of Reporting Manager:

Name: ______________________
Title: ______________________
Phone: ______________________

Signature, Place, and Date of Signing

________________________ ________________ __________
[Signature] [City, State] [Date]

Report Type (Check only one):

[ ] FORM SH ENTRIES REPORT. (Check here if all entries of this reporting manager are reported in this report.)
[ ] FORM SH NOTICE. (Check here if no entries reported are in this report, and all entries are reported by other reporting manager(s).)
[ ] FORM SH COMBINATION REPORT. (Check here if a portion of the entries for this reporting manager is reported in this report and a portion is reported by other reporting manager(s).)

List of Other Managers Reporting for this Manager:
[If there are no entries in this list, omit this section.]

Form 13F File Number	Name
28-__________	______________________________

[Repeat as necessary.]

OMB Number: 3235-0646

FORM SH SUMMARY PAGE

Report Summary:

Number of Other Included Managers: ____________________

Form SH Information Table Entry Total: ____________________

Form SH Information Table Value Total: ____________________
(thousands)

List of Other Included Managers:

Provide a numbered list of the name(s) and Form 13F file number(s) of all institutional investment managers with respect to which this Form SH report is filed, other than the manager filing this report.

[If there are no entries in this list, state "NONE" and omit the column headings and list entries.]

No.	Form 13F File Number	Name
___	28-________________________	____________________________________

[Repeat as necessary.]

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 1
SUNDAY, ______[Month, Day, Year]________

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7	Column 8
Name of Issuer	CUSIP	Short Position (Start of Day)	Number of Securities Sold Short (Day)	Value of Securities Sold Short (Day) (x $1000)	Short Position (End of Day)	Largest Intraday Short Position	Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 2
MONDAY, ______[Month, Day, Year]______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 3

TUESDAY, ______[Month, Day, Year]______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 4
WEDNESDAY, ______ [Month, Day, Year] ______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 5

THURSDAY, ______ [Month, Day, Year] ______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 6

FRIDAY, _____[Month, Day, Year]______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

OMB Number: 3235-0646

FORM SH INFORMATION TABLE –PAGE 7
SATURDAY, ______[Month, Day, Year]______

Column 1 Name of Issuer	Column 2 CUSIP	Column 3 Short Position (Start of Day)	Column 4 Number of Securities Sold Short (Day)	Column 5 Value of Securities Sold Short (Day) (x $1000)	Column 6 Short Position (End of Day)	Column 7 Largest Intraday Short Position	Column 8 Time of Day of Largest Intraday Short Position

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM SH

INFORMATION REQUIRED OF INSTITUTIONAL INVESTMENT MANAGERS PURSUANT TO EMERGENCY ORDER, SECURITIES EXCHANGE ACT OF 1934 RELEASE NO. 58591A, SEPTEMBER 21, 2008 AND EMERGENCY ORDER, SECURITIES EXCHANGE ACT OF 1934 RELEASE NO. 58724, OCTOBER 2, 2008

GENERAL INSTRUCTIONS

1. Rule as to Use of Form SH. Institutional investment managers ("Managers") must use Form SH for reports to the Commission required by the Commission's Emergency Order, Securities Exchange Act of 1934 Release No. 58591A, September 21, 2008 and Emergency Order, Securities Exchange Act Release No. 58724, dated October 2, 2008 (together, the "Form SH Emergency Orders"). The Form SH Emergency Orders provide that every Manager that exercises investment discretion with respect to accounts holding section 13(f) securities, as defined in rule 13f-1(c) under the Securities Exchange Act of 1934 [15 U.S.C. 78m(f)] ("Exchange Act"), who has filed or was required to file a Form 13F for the calendar quarter ended June 30, 2008, must file a non-public report on Form SH with the Commission to report certain information about short sales and short positions. The non-public Form SH filing must be made on the Monday (or, if Monday is a federal holiday, the first business day thereafter) of each calendar week immediately following a Form SH reporting period (*i.e.*, the preceding Sunday-Saturday calendar week) in which the Manager has entered into any new short positions with respect to any section 13(f) securities except for any short position(s) for options ("SH Short Positions"). The non-public Form SH will report SH Short Positions for the Sunday-Saturday calendar week that precedes the date on which the Form SH is due to be filed.

2. Rules to Prevent Duplicative Reporting. If two or more Managers, each of which is required by the Form SH Emergency Orders to file a report on Form SH for the reporting period, exercise investment discretion with respect to the same securities, only one such Manager must include information in its reports on Form SH.

   A Manager having information that is required by the Form SH Emergency Orders to be reported on Form SH, and such information is reported by another Manager (or Managers), such Manager must identify the Manager(s) reporting on its behalf in the manner described in Special Instruction 6.

3. Filing of Form SH. **A Form SH report that is filed by a Manager with the Commission shall be non-public upon filing. A Manager must label its Form**

SH as non-public by adding the phrase NON-PUBLIC (in bold and capital letters) at the top and bottom of each page of the entire form, *i.e.*, each page(s) of the Form SH Cover Page (the "Cover Page"), the Form SH Summary Page (the "Summary Page"), and the Form SH Information Table (the "Information Table").

A Manager must file a Form SH report with the Commission on or before 5:30 p.m. Eastern Daylight Time on the Monday (or, if Monday is a federal holiday, the first business day thereafter) of each week immediately following the preceding seven calendar day period in which the Manager has entered into any new SH Short Position(s). **The Form SH must be filed electronically using the Commission's EDGAR system.**

4. Official List of Section 13(f) Securities. The official list of section 13(f) securities published by the Commission (the "13F List") lists the securities the holdings of which a Manager is to report on Form 13F. *See* rule 13f-1(c) [17 CFR 240.13f-1(c)]. Form SH filers may rely on the current 13F List in determining whether they need to report on Form SH information about any particular equity security, excluding short positions for options that are on the 13F List. The 13F List is available on the SEC's website, at http://www.sec.gov/divisions/investment/13flists.htm. Paper copies are available at a reasonable fee from the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549.

SPECIAL INSTRUCTIONS

1. This form consists of three parts: the Cover Page, the Summary Page, and the Information Table.

2. When preparing the report, omit all bracketed text. Include brackets used to form check boxes.

The Cover Page:

3. The period end date used in the report (and in the EDGAR submission header) is the Saturday before the Form SH is filed. The date should name the month, and express the day and year in Arabic numerals, with the year being a four-digit numeral (*i.e.*, 2008).

4. Amendments to a Form SH must either restate the Form SH in its entirety or include only entries that are being reported in addition to those already reported in a current Form SH for the same period. If the Manager is filing the Form SH report as an amendment, then the Manager must check the amendment box on the Cover Page; enter the amendment number; and check the appropriate box to indicate whether the amendment (a) is a restatement or (b) adds new entries. Each amendment must include a complete Cover Page and, if applicable, a Summary Page and Information Table. Amendments must be filed sequentially.

5. Present the Cover Page and the Summary Page information in the format and order provided in the form. The Cover Page may include information in addition to the required information, so long as the additional information does not, either by its nature, quantity, or manner of presentation, impede the understanding or presentation of the required information. Place all additional information after the signature of the person signing the report (immediately preceding the Report Type section). Do not include any additional information on the Summary Page or in the Information Table.

6. Designate the Report Type for the Form SH by checking the appropriate box in the Report Type section of the Cover Page, and include, where applicable, the List of Other Managers Reporting for this Manager (on the Cover Page), the Summary Page and the Information Table, as follows:

   a. If all of the information that a Manager is required by the Form SH Emergency Orders to report on Form SH is reported by another Manager (or Managers), check the box for Report Type "FORM SH NOTICE," include (on the Cover Page) the List of Other Managers Reporting for this Manager, and omit both the Summary Page and the Information Table.

   b. If all of the information that a Manager is required by the Form SH Emergency Orders to report on Form SH is reported in this report, check the box for Report Type "FORM SH ENTRIES REPORT," omit from the Cover Page the List of Other Managers Reporting for this Manager, and include both the Summary Page and the Information Table.

   c. If only a part of the information that a Manager is required by the Form SH Emergency Orders to report on Form SH is reported in this report, check the box for Report Type "FORM SH COMBINATION REPORT," include (on the Cover Page) the List of Other Managers Reporting for this Manager, and include both the Summary Page and the Information Table.

Summary Page:

7. Include on the Summary Page the Report Summary, containing the Number of Other Included Managers, the Information Table Entry Total and the Information Table Value Total.

   a. Enter as the Number of Other Included Managers the total number of other Managers listed in the List of Other Included Managers on the Summary Page, not counting the Manager filing this report. *See* Special Instruction 8. If none, enter the number zero ("0").

   b. Enter as the Information Table Entry Total the total number of line entries providing issuer information included in the Information Table.

c. Enter as the Information Table Value Total the aggregate fair market value in U.S. dollars (x $1000) of all securities sold short during the reporting period that are required to be reported on Form SH. The Information Table Value Total is determined by multiplying the Number of Securities Sold Short (Day) (Column 4) by the closing market price of the security on that day, or, when applicable, the most recent business day. The Manager must express this total as a rounded figure. *See* Special Instruction 9.

8. Include on the Summary Page the List of Other Included Managers. Use the title, column headings and format provided.

   a. If this Form SH does not report the information that a Manager is required by the Form SH Emergency Orders to report on Form SH of any Manager other than the Manager filing this report, enter the word "NONE" under the title and omit the column headings and list entries.

   b. If this Form SH reports the information that a Manager is required by the Form SH Emergency Orders to report on Form SH of one or more Managers other than the Manager filing this report, enter in the List of Other Included Managers all such Managers together with their respective Form 13F file numbers, if known. (The Form 13F file numbers are assigned to Managers when they file their first Form 13F). Assign a number to each Manager in the List of Other Included Managers, and present the list in sequential order. The numbers need not be consecutive. The List of Other Managers cannot include the Manager filing this report.

Information Table:

9. In determining the fair market value of securities sold short, a Manager must use the market price of the section 13(f) securities as of the close of floor trading on the New York Stock Exchange ("NYSE") for the day in question. If the securities are sold short on a non-business day, a Manager must use the market price of the section 13(f) securities as of the close of the NYSE for the most recent business day. Such market closing time shall be used to determine the price for all SH Short Positions, irrespective of which U.S. equity market the issuer trades on. Enter values rounded to the nearest one thousand dollars (with "000" omitted).

10. Furnish the Information Table using the table title, column headings and format provided. Provide column headings once at the beginning of each page of the Information Table . Present the table in accordance with the column instructions provided in Special Instructions 10.a.i through 10.a.viii. Do not include any additional information in the Information Table. Begin the Information Table on a new page for each day of the prior calendar week, and number any supplemental pages for a day using the page number and upper case letters (*e.g.*, Monday-Page 2, Monday-Page 2A, Monday-Page 2B, etc.). Do not include any portion of the Information Table on either the Cover Page or the Summary Page.

a. Instructions for each column in the Information Table:

i. Column 1. Name of Issuer. Enter in Column 1 the name of the issuer as it appears in the current 13F List. Reasonable abbreviations are permitted.

ii. Column 2. CUSIP Number. Enter in Column 2 the nine (9) digit CUSIP number of the security for which information is being reported.

iii. Column 3. Short Position (Start of Day). Enter in Column 3 the number of securities that represent the Manager's short position in the issuer as of the start of each calendar day during the reporting period. The Short Position (Start of Day) for Monday, September 22, 2008 shall be zero.

iv. Column 4. Number of Securities Sold Short (Day). Enter in Column 4 the aggregate number of securities in the issuer that the Manager sold short for each calendar day during the reporting period.

v. Column 5. Value of Securities Sold Short (Day). Enter in Column 5 the market value in U.S. dollars (x $1000) of the number of securities reported in Column 4. In valuing such securities, use the fair market value for each security. *See* Special Instruction 9.

vi. Column 6. Short Position (End of Day). Enter in Column 6 the number of securities that represent the Manager's short position in the issuer as of the end of each calendar day during the reporting period.

vii. Column 7. Largest Intraday Short Position. Enter in Column 7 the number of securities that represent the Manager's largest single short position in the issuer for each calendar day during the reporting period.

viii. Column 8. Time of Day of Largest Intraday Short Position. Enter in Column 7 the time of day (Eastern Daylight Time) that the Manager had the largest single short position in the issuer, as reported in Column 7.

11. Preparation of the electronic filing:

Filing documents may be submitted in either ASCII or HTML document format. For ASCII submissions, please note items a, b, and c. Preparation of the filing document should follow instructions in the EDGAR Filer Manual, (Volume 2) EDGAR Filing available on the SEC's website at http://www.sec.gov/info/edgar/edmanuals.htm.

a. No line on the Cover Page or the Summary Page may exceed 80 characters in length. *See* rule 305 of Regulation S-T [17 CFR 232.305]. The EDGAR <TABLE> tag may be used if it is necessary to increase the width of a line on the Cover Page or the Summary Page in a Form SH that is formatted in ASCII. *See* EDGAR Filer Manual (Volume 2) for details on the use of this tag.

b. No line in the Form SH Information Table may exceed 132 characters in length. *See* rule 305 of Regulation S-T [17 CFR 232.305].

c. If the Form SH Report Type is "SH ENTRIES REPORT" or "SH COMBINATION REPORT," then place one EDGAR <PAGE> tag at the end of the Cover Page and one <PAGE> tag at the end of the Summary Page. Additional EDGAR <PAGE> tags are not required. Those electing to include additional <PAGE> tags should, for each page containing a <PAGE> tag, include no more than sixty (60) lines per page, including the line on which the <PAGE> tag is placed.

d. In preparing the Form SH report for electronic filing, a Manager may omit underscoring used in the form to indicate the placement of information that the Manager is to furnish.

e. Use the following EDGAR submission types for the following Form SH Report Types:

Form SH Report Type	EDGAR Submission Type
FORM SH ENTRIES REPORT	
Initial Filing	SH-ER
Amendments	SH-ER/A
FORM SH NOTICE	
Initial Filing	SH-NT
Amendments	SH-NT/A
FORM SH COMBINATION REPORT	
Initial Filing	SH-ER
Amendments	SH-ER/A

Filings with the form types set forth in this instruction will be filed on a non-public basis.

Paperwork Reduction Act Information

The Office of Management and Budget has approved this collection of information pursuant to 44 U.S.C. § 3507 and 5 C.F.R. § 1320.13. The OMB control number for this collection of information is 3235-0646. 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 control number. We estimate that providing the requested information will take, on average, approximately 5 hours. Any member of the public may direct to the Commission any comments concerning the accuracy of this burden estimate and any suggestions for reducing this burden. *See* Form SH Emergency Orders regarding confidentiality.

T-01A

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33- 8974, 34- 58715, IA-2796, IC-28432, File No. S7-28-08]

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission approved the publication of an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act. The agenda, which is not a part of or attached to this document, was submitted by the Commission to the Regulatory Information Service Center for inclusion in the Unified Agenda of Federal Regulatory and Deregulatory Actions, which is scheduled for publication in its entirety on www.reginfo.gov in October 2008. The version of the Unified Agenda to be published in the Federal Register will include only those rules for which the agency has indicated that preparation of an analysis under the Regulatory Flexibility Act is required. Information in the Commission's agenda was accurate on October 2, 2008, the date on which the Commission's staff completed compilation of the data. To the extent possible, rulemaking actions by the Commission after that date will be reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

DATES: Comments should be received on or before December 31, 2008.

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/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-28-08 on the

publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda, and that an agency is not required to consider or act on any matter that is included in the agenda (5 U.S.C. 602(d)). Actions that do not have an estimated date are placed in the long term category; the Commission may nevertheless act on items in that category within the next twelve months. The agenda includes new entries, entries carried over from previous publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda. The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 2, 2008

Commissioner Walter and Commissioner Aguilar not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 58737 / October 6, 2008

Admin. Proc. File No. 3-12659

In the Matter of the Application of

MICHAEL FREDERICK SIEGEL
c/o George C. Freeman, III
Barrasso Usdin Kupperman Freeman & Sarver, LLC
909 Poydras Street, Suite 2400
New Orleans, Louisiana 70112

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Conduct Rules

Failure to Provide Written Notice to Member Firm Employer Regarding Private Securities Transactions

Unsuitable Recommendations

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered representative of member firm of registered securities association participated in private securities transactions without providing prior written notice to his member-firm employer, made unsuitable recommendations, and, as a result, engaged in conduct inconsistent with just and equitable principles of trade. Held, association's findings of violations and sanctions are sustained.

APPEARANCES:

George C. Freeman, III and Meredith A. Cunningham, of Barrasso Usdin Kupperman Freeman & Sarver, LLC, for Michael Frederick Siegel.

Marc Menchel, James S. Wrona, and Michael J. Garawski, for FINRA.

Appeal filed: January 3, 2008
Last brief received: April 24, 2008

I.

Michael Frederick Siegel, formerly a general securities representative associated with Rauscher Pierce Refsnes, Inc. ("Rauscher"), an NASD member firm, appeals from NASD disciplinary action. 1/ NASD found that Siegel engaged in private securities transactions without providing prior written notice to Rauscher in violation of NASD Conduct Rules 3040 and 2110. 2/ NASD also found that Siegel made unsuitable recommendations to two couples in violation of NASD Conduct Rules 2310 and 2110. NASD fined Siegel a total of $30,000, ordered him to serve consecutively two six-month suspensions in all capacities, ordered restitution to the customers at issue in the amount of $400,300, and assessed costs of $7,958.05. We base our findings on an independent review of the record.

1/ On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Although FINRA issued the Supplemental Decision on restitution, NASD initiated the original disciplinary action. We will we continue to use the designation NASD.

2/ NASD Conduct Rule 3040(e)(1) defines "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded."

II.

Siegel's Involvement with World Environmental Technologies, Inc.

Siegel has been registered as a general securities representative since 1981 and was associated with Rauscher from October 24, 1997 until June 16, 1999. 3/ At the beginning of 1997, Siegel met World Environmental Technologies, Inc. ("World ET") president, Jim Finkenkeller, and the chairman of World ET's board, Tom Denmark, to discuss a business opportunity. During several meetings with Finkenkeller and Denmark over the next three or four months, Siegel learned that World ET recently had been founded to offer antibacterial services to the poultry and swine industry and intended to acquire the rights to an odor-eradicating product called "Nok-Out."

Sometime in late 1997, Siegel agreed to become a director of World ET and to raise capital for the Nok-Out venture. He believed that, as a director, he would be well positioned to be selected for the company's potential initial public offering. In a letter dated October 22, 1997, Finkenkeller informed Siegel that World ET immediately required Siegel's fundraising efforts in connection with, among other things, fulfilling a "$200,000 commitment" and obtaining "operating capital" and that Siegel could show his "investors" a "small job" that World ET was to perform at the end of the month.

On November 24, 1997, Siegel requested in writing permission from Rauscher to serve as a director of World ET. Siegel represented that he was not recommending World ET securities to his customers. Rauscher granted Siegel permission to serve as a director but informed Siegel that he would "not be able to effect transactions in the securities of World [ET] . . . ." At the hearing, Siegel testified that his supervisor, Scott Grandbouche, told him that it was highly unlikely that Rauscher would ever approve a Rauscher registered representative selling unregistered securities. 4/ Rauscher never approved Siegel's offer or sale of World ET securities.

On December 6, 1997, Finkenkeller sent Siegel a draft employment agreement that provided that Siegel would use his best efforts to obtain, by March 31, 1998, at least $15 million to fund World ET's "development and operations" in exchange for payments of cash and stock. Siegel signed the agreement in January 1998. In the executed agreement, Siegel substituted his home address for his office address for the purpose of receipt of all "notices, demands, and requests" under the agreement ("Notice Provision"). Grandbouche testified that all mail received

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3/ Siegel also has been active as a radio and television personality providing investment advice since the mid-1980s, a registered investment adviser since 1999, and the author of a book entitled, "Investing for Cowards," published in 2001.

4/ Siegel testified that he later told Grandbouche that his "clients wanted to invest in World ET [and] do it on their own," but Grandbouche denied that Siegel told him anything about the transactions at issue.

through the firm was opened and reviewed by administrative personnel before being delivered to a registered representative. Siegel never informed Rauscher about his employment agreement with World ET.

When Siegel signed the employment agreement, he also loaned World ET $22,000. On March 6, 1998, Siegel loaned World ET an additional $20,166.01. Siegel testified that he was unclear about what repayment terms, interest rates, or maturity dates applied to the loans he made to World ET. World ET failed to pay Siegel for his services as a director or pursuant to the employment agreement or to repay any portion of his two loans to the company.

Siegel's Dealings with the Downers

Huntington and Linda Downer had been investing with Siegel since 1993. 5/ Siegel had discretion over their account. Over time, Siegel invested their funds in a combination of fixed-income products, mutual funds, and stock. 6/ The Downers testified that they had invested mainly in certificates of deposit prior to investing with Siegel and "looked to him for financial guidance."

Seven days after Siegel became associated with Rauscher in October 1997, the Downers transferred all of their holdings from their account maintained at Siegel's previous firm to a new discretionary joint account with Rauscher. In early November 1997, Siegel visited the Downers' home to discuss their account, as he had done routinely since they began investing with him. During the visit, Siegel brought up World ET. He told the Downers that World ET was a new company and that he was going to invest in the company. Siegel also told the Downers that World ET planned on acquiring the rights to "Nok-Out." He said that he was very excited about the formula (which he described to them) and gave them a sample of "Nok-Out" to use on their cat's litter box. Based on Siegel's representation that he was investing in World ET, Huntington Downer asked Siegel to contact the company to inquire about any investment opportunities for the Downers. Following the visit, Siegel spoke with Finkenkeller or Denmark who informed him that the Downers could invest $300,000 in World IEQ Technologies, Inc. ("World IEQ"), purportedly a subsidiary of World ET. Siegel conveyed this information to the Downers who asked him to obtain the relevant paperwork on their behalf.

On November 24, 1997, Siegel visited the Downers a second time and brought with him several documents related to World IEQ. The World IEQ subscription agreement provided that

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5/ Huntington Downer earned $150,000 annually as a legislator and focused on finance and budget issues. Downer previously had been a partner in a law firm. Linda Downer, his wife, had no separate income. The Downers had a net worth of approximately $1.5-2.0 million, excluding their home.

6/ The Downers relied on the income generated from their investments and sought growth and income as their investment objective.

the subscriber waived the right to receive a document "typically called a Prospectus or Private Placement Memorandum." It also provided that a subscriber's $300,300 investment would purchase a 120-day debenture for $300,000 plus 300,000 shares of World IEQ common stock for $300 at $0.001/share. The World IEQ questionnaire, in contrast, requested that the subscriber confirm the purchase of a 365-day debenture for $300,000 plus 300,000 shares of "Class Common Stock" without specifying a price. The documents contained no information regarding an interest rate or repayment terms for the debenture.

Siegel testified that he did not review or analyze any of the documents. Without completing any blank sections or discussing the contents of the documents with Siegel, Huntington Downer signed and returned to Siegel the World IEQ subscription agreement and the World IEQ questionnaire. Huntington Downer testified that he often signed documents that Siegel provided without reviewing them or questioning Siegel. 7/ Linda Downer gave Siegel a personal check made payable to World IEQ in the amount of $300,300. She testified that, "I know that sounds really strange to invest $300,000 [sic] in something that you know nothing about, but . . . I trusted [Siegel] to do whatever." Siegel faxed the forms to World ET.

Shortly thereafter, the Downers decided to pay for the World IEQ investment by using funds from their Rauscher account instead of paying with the check that Linda Downer wrote and which was never negotiated. Siegel provided, and the Downers signed, a letter dated November 28, 1997 that authorized him to wire $300,300 from their Rauscher account to a World IEQ bank account in Texas. Rauscher effected the wire transfer on December 1, 1997.

Approximately one or two weeks later, Finkenkeller called Siegel and told him that the Downers could no longer invest in World IEQ and had the option of receiving a refund or investing in World ET. Siegel conveyed this information to the Downers. When Huntington Downer asked Siegel for advice on how to decide, Siegel stated that he "would rather be in the mother company if [he] had a choice." The Downers told Siegel that they opted to invest in World ET. Siegel was the Downers' only source of information regarding their decision to invest in World IEQ and World ET.

Siegel's Contacts with the Landrys

Dorothy and Barry Landry opened a Rauscher account with Siegel in November 1997 based on a referral by Huntington Downer. The Landrys vested Siegel with discretion over their account. The Landrys sought to increase the return on $1 million that they acquired from the

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7/ For example, Huntington Downer testified, "Mr. Siegel was my friend. He would come to my house. He would give me recommendations. Whatever he said, whatever he put in front of me, I signed. I trusted him implicitly. I never once filled out any forms, to the best of my recollection. He filled out whatever and showed me where to sign, and I signed."

recent sale of their healthcare business. Siegel told them that he subsequently might recommend that they invest in higher-risk, start-up companies.

Later that month, Siegel visited the Landrys' home to complete some follow-up paperwork regarding their new account and to discuss their portfolio. Siegel raised the topic of World ET, stating that he thought it was something in which they might be interested and that he wanted them "to take a look at" the company. Siegel told them that World ET was a new company that intended to introduce Nok-Out to the poultry and swine industry and that he and the Downers were investing "three times" the minimum investment amount in the company.

The Landrys testified that, while Siegel did not pressure them to invest, he did "promote the benefits of [Nok-Out]" and assure them that "this looked like a really good deal." For example, Dorothy Landry testified that Siegel told them that Nok-Out "looked like a product that . . . is going to be needed" and "is going to have lots of sales," that it "could be global," that "the opportunities existed to get in on the ground floor," and that "distribution is going to be coast-to-coast almost immediately because of the nature of the poultry and swine industries." Barry Landry testified that Siegel told them that he "knew of a company [i.e., World ET] that was on its ground floor getting started up and might be a nice place to invest some money," and that "it looked like a good idea." Dorothy Landry testified that Siegel told the couple that the minimum investment amount was $100,000 and that they could get their money back in as little as ninety days or perhaps one year.

Dorothy Landry asked Siegel to call World ET to determine whether any investment opportunity existed. Siegel said he would be "glad to" and called Denmark when he returned to his office. After speaking with Denmark, Siegel told the Landrys that they could invest in World ET.

On a subsequent visit a couple of weeks later, Siegel gave the Landrys a folder containing World ET documents and including Siegel's Rauscher business cards. 8/ Siegel testified that he did not review the documents or discuss them with the Landrys. A World ET subscription agreement provided that a subscriber could invest in a debenture at $100,000 per "unit" and would waive the right to receive a document "typically called a Prospectus or Private Placement Memorandum." A World ET strategic plan described World ET's first-year plan to provide odor- and bacteria-combating services to the swine industry, with a "[s]econdary focus" in the poultry industry. Siegel also gave the Landrys a World ET outline and a World ET "pro forma summary information" statement that contained conflicting repayment terms. None of the documents contained information about an interest rate or a maturity date for the debenture.

8/ The record is unclear as to whether the information related directly to World ET or to a subsidiary whose name was listed inconsistently in the documents. Resolution of this issue is not relevant to our disposition of Siegel's appeal. However, in the interest of clarity, we will use the designation World ET.

On Siegel's advice, the Landrys kept the documents to review for a couple of months before making a decision on whether to invest in World ET. Dorothy Landry testified that Siegel's planned investment in World ET led them to the conclusion that, "if [Siegel] was interested in it, consider it solid." The Landrys testified that learning from Siegel that the Downers had invested in World ET further validated their decision to invest.

On February 5, 1998, the Landrys faxed to Rauscher and Siegel a request to wire transfer $100,000 from their Rauscher account to their joint bank account with Hibernia National Bank, which Rauscher effected on that same day. On February 11, 1998, the Landrys gave the signed World ET subscription agreement and a $100,000 check made payable to World ET to Siegel, who sent them to World ET. World ET negotiated the check. Siegel was the Landrys' only source of information about World ET prior to making their investment decision.

World ET Goes Out of Business

Pursuant to an arbitration decision rendered on August 28, 2002, World ET lost the rights to Nok-Out because World ET defaulted on payments it owed to the company that had developed the product. On February 13, 2004, the Texas Secretary of State revoked World ET's corporate charter. The Downers and Landrys never received any payments of any kind on their World ET investments.

Siegel's Testimony at the Hearing

Siegel testified that he believed the Downers invested in World IEQ because he told them that he was going to invest in World ET. Siegel further testified that the World IEQ and World ET documents that he provided to the Downers and Landrys were deficient because they either lacked or contained conflicting or confusing information about details that private placement transaction documents typically specify, such as maturity dates, interest rates, and repayment terms.

Siegel conceded at the hearing that these documentary deficiencies rendered an investment in World IEQ and World ET unsuitable for the Downers, the Landrys, or any investor. For example, Siegel agreed with an NASD hearing panelist who commented at the hearing that, with respect to the World IEQ and World ET documents, "[t]his is one of the worst sets of offering documents I have ever seen in my life. I mean you can't tell what these people are investing in." Siegel also stated, "I didn't know how bad they were because I was trying to not sell away. . . . Had I looked over the documents, yes, I probably would have been discouraged with the company right then and there. I didn't look them over. I wish I had." Siegel did not claim at any time during the proceeding, and the record does not indicate, that his communications with Finkenkeller or Denmark or his position as a World ET director provided him any additional information about the potential risks and rewards associated specifically with a World ET investment.

Procedural Background

On November 26, 2002, NASD's staff filed a complaint against Siegel alleging that he engaged in private securities transactions without providing prior written notice to Rauscher and that he made unsuitable recommendations to both the Downers and the Landrys. On April 19, 2004, an NASD Hearing Panel found that Siegel had committed the violations alleged in the complaint. The Hearing Panel fined Siegel $30,000 and ordered him to serve concurrently two six-month suspensions in all capacities.

Siegel appealed and NASD staff cross-appealed the decision to NASD's National Adjudicatory Council ("NAC"). On July 26, 2005, the NAC remanded the proceeding and ordered the Hearing Panel to make credibility determinations and supplemental findings as to Siegel's interactions with the Landrys.

On May 11, 2007, the NAC affirmed the Hearing Panel's March 16, 2006 findings of violation and credibility determination in favor of the Landrys. The NAC also affirmed the Hearing Panel's sanctions, except that it ordered Siegel to serve his suspensions consecutively and to pay restitution to the Downers and Landrys in the amount of $400,300. The NAC found that the record evidence was insufficient to make a determination whether the restitution amount was subject to offset. Accordingly, the NAC ordered a NAC Subcommittee to make a recommendation to the NAC regarding the offset amount.

The NAC Subcommittee denied Siegel's request for an in-person evidentiary hearing. Siegel did not dispute that the Downers and the Landrys never sold their investments in World securities, that their World securities have no residual value, and that they recovered no restitution through other avenues. Based on documentary evidence, including affidavits submitted by Siegel and NASD staff, the NAC subcommittee recommended that no offset be imposed. On that basis, the NAC concluded that no offset was required in its supplemental decision dated December 4, 2007.

III.

Pursuant to Section 19(e) of the Securities Exchange Act of 1934, we will sustain NASD's decision if the record shows by a preponderance of the evidence that Siegel engaged in conduct that NASD found to have violated its rules and that NASD applied its rules in a manner consistent with the purposes of the Exchange Act. 9/

Private Securities Transactions

NASD Conduct Rule 3040 prohibits an associated person from participating "in any manner" in a private securities transaction without prior written notification to the employer, i.e.,

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9/ 15 U.S.C. § 78s(e).

selling away. 10/ Siegel does not dispute that he violated NASD Conduct Rule 3040. Siegel stipulated before NASD that the investments made by the Downers and Landrys in World ET involved securities. 11/ Siegel admits that he participated in the private securities transactions at issue. Among other things, he introduced World ET to the customers, was the customers' sole source of information about World ET prior to their investments, and facilitated their purchases of World ET. 12/ Siegel further admits that he did not provide prior written notice to Rauscher of his participation in the sales activity at issue.

Accordingly, we find that Siegel participated in private securities transactions without providing prior written notice to Rauscher in violation of NASD Conduct Rules 3040 and 2110. 13/

Unsuitable Recommendations

Siegel Made Recommendations. NASD Conduct Rule 2310 requires that a transaction recommended by a registered representative to a customer be suitable. Whether the

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10/ Joseph Abbondante, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 214, aff'd, 209 Fed. Appx. 6 (2nd Cir. 2006) (Unpublished); NASD Manual at 4836-37 (1998). NASD Conduct Rule 3040 also provides that if an associated person is to receive selling compensation, he must give prior written notice to the firm and receive written approval before engaging in the transaction. NASD stipulated that it did not contend that Siegel received any commission or other compensation in connection with any investments made by the customers at issue in World ET or its subsidiaries. Thus, selling compensation is not an issue in this proceeding.

11/ Exchange Act Section 3(a)(10) defines the term "security" to include "any" "stock" or "debenture." 15 U.S.C. § 78c(a)(10). The subscription agreements signed by the Downers and the Landrys each stated that an investment resulted in the purchase of a debenture, as well as stock. The parties do not dispute that each of the World ET investments purchased by the Downers and the Landrys was a security. We agree with NASD's finding that these investments were securities.

12/ See Abbondante, 87 SEC Docket at 216 (finding that applicant participated in private securities transactions by introducing security to customers, being the sole source of information about the security, and facilitating purchase of security).

13/ NASD Conduct Rule 2110 requires NASD members to observe high standards of commercial honor and just and equitable principles of trade. NASD Manual at 4111. NASD General Provisions Rule 115 extends the applicability of NASD rules governing members to their associated persons. It is well settled that a violation of a Commission or NASD rule or regulation also constitutes a violation of Conduct Rule 2110. E.g., Stephen J. Gluckman, 54 S.E.C. 175, 185 (1999).

communication between a registered representative and a customer constitutes a recommendation is a "'facts and circumstances' inquiry to be conducted on a case-by-case basis." 14/ Such an inquiry "requires an analysis of the content, context, and presentation of the particular communication." 15/ NASD has stated that factors considered in conducting this inquiry include whether the communication "reasonably could be viewed as a 'call to action'" and "reasonably would influence an investor to trade a particular security or group of securities." 16/ For the reasons set forth below, we find that Siegel's communications with the Downers and the Landrys constitute recommendations.

The nature of the relationship between Siegel and his customers, their reliance on him, the nature of the specific conversations, and Siegel's initiation of the subject of World ET are the main factors supporting a finding that Siegel made recommendations. Siegel visited the Downers' home in November 1997 to discuss their portfolio. Siegel raised the topic of investing in World ET during that discussion. The Downers had never heard of World ET. Siegel was the Downers' sole source of information about the company. He told the Downers that he was very excited about Nok-Out. Siegel also told the Downers that he was going to invest in the company. 17/ The Downers had sought Siegel's investment guidance for three years and routinely deferred to his decisions without question. Siegel admitted that he believed the couple invested in World ET because he told them that he planned on investing in the company. Siegel claims that his communications with the Downers were merely conversations about World ET, but we disagree.

Siegel made further inquiries, obtained and conveyed information, and facilitated execution of subscription documents and payment for the purchase of World IEQ shares. After Siegel informed the Downers that it was no longer possible to invest in World IEQ, he advised them to invest in World ET rather than receive a refund on their World IEQ investment, stating that he "would rather be in the mother company if [he] had a choice." Siegel admits that he could have refused Huntington Downer's request to obtain additional information about investing in World ET.

With respect to the Landrys, Siegel raised the topic of investing in World ET while reviewing their portfolio. He was the Landrys' sole source of information about the company

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14/ NASD Notice to Members, 01-23 (Apr. 2001).

15/ Id.

16/ Id.

17/ Siegel testified that he also informed the Downers and the Landrys that he was going to become a director of World ET. The Downers and the Landrys testified that he did not disclose this fact. Resolution of this issue is not necessary for us to determine whether Siegel's communications with his customers were recommendations.

prior to making their investment decision. Siegel told the Landrys that he and the Downers were investing "three times" the minimum investment amount in the company. The Landrys testified that the knowledge that Siegel and the Downers also were investing in World ET comforted them. He gave them glowing projections about its potential success. Siegel made encouraging statements about the investment and proceeded on behalf of the Landrys to make further inquiries, obtain and convey information, deliver documents, return executed originals, and facilitate payment to World ET.

We find that Siegel's conduct constitutes a recommendation because it was a "call to action" that reasonably influenced the Downers and the Landrys to invest in World ET. The Downers and the Landrys relied on Siegel for investment advice. Within the context of Siegel's visits to the Downers and the Landrys to provide such advice, he introduced them to World ET, made encouraging statements about investing in World ET, and facilitated his customers' overall investments.

Siegel's Arguments. Siegel contends that the NAC improperly found that he made a recommendation to the Downers "only by ignoring key evidence." In support of that argument, he claims that the Downers "were able to distinguish a recommendation – a 'call to action' – from the mere mention of a company in personal conversation" because they are "among the most sophisticated investors under the law" and thus able to "fend for themselves." However, while sophistication of the investor may be relevant, sophistication alone does not mean that a communication is not a recommendation. Siegel did not merely mention World ET to the Downers. He repeatedly provided the Downers with positive details about the company and associated investment opportunities during ongoing conversations that began in the context of his periodic review of their investments.

Siegel claims that Huntington Downer initiated the idea of investing in World ET and insisted on investing. However, Downer was aware of World ET only because Siegel brought it to his attention and spoke enthusiastically about its prospects. Siegel also claims that he told the Downers not to invest simply because he was investing and that they would be on their own if they did decide to invest and that he discouraged Huntington Downer from investing in World ET by advising him that "he would have to wait until the company went public." Yet, these statements do not change the conclusion that he made a recommendation. Siegel provided significant information and assistance to the Downers in making their investment in World ET while it was a nonpublic company, including encouraging them to invest in World ET after learning they could not invest in World IEQ.

Siegel asserts that, "[g]iven its election to forego any credibility findings as to the Downers, the NAC was required to constrain its review [regarding whether Siegel made a recommendation to the Downers] to Siegel's testimony." Siegel's argument is without merit. In the absence of a credibility finding with respect to the Downers' testimony, the NAC was required to conduct a de novo review and was permitted to make its findings based on a review of the entire record. 18/ We also have conducted a de novo review. 19/

Siegel does not dispute that he recommended an investment in World ET to the Landrys. The Hearing Panel credited the Landrys' testimony on this issue. It is well established that we defer to the credibility determination of a fact-finder. 20/ We see no reason to question the Hearing Panel's determination here. We find that Siegel made recommendations to the Downers and the Landrys within the meaning of NASD Conduct Rule 2310. 21/

Siegel's Recommendations Were Unsuitable. NASD Conduct Rule 2310 requires that, in recommending a transaction to a customer, a registered representative "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." 22/ The suitability rule thus requires that, before making a customer-specific suitability determination, a registered representative must first have an "adequate and reasonable basis" for believing that the recommendation could be suitable for at least some

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18/ See Michael B. Jawitz, 55 S.E.C. 188, 200 & n.24 (2001) (stating that the NAC conducts a de novo review and has broad discretion to review any finding in the Hearing Panel decision) (citing Timothy L. Burkes, 51 S.E.C. 356, 359 (1993), aff'd, 29 F.3d 630 (9th Cir. 1994) (Table)); cf. Morton Bruce Erenstein, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3126 (acknowledging the NAC's power to conduct a de novo review and make its own independent findings), petition denied, No. 07-15736 (11th Cir. 2008) (Unpublished).

19/ See Keith Springer 55 S.E.C. 839, 841 n.5 (2002) ("Our de novo review of the record [under Exchange Act Section 19(e)] permits us to make our own findings based on a review of all material in the record."); Kenneth C. Krull, 53 S.E.C. 1101, 1109 (1998), aff'd, 248 F.3d 907 (9th Cir. 2001).

20/ E.g., Stephen Michael Sohmer, 57 S.E.C. 240, 255 & n.27 (2004) (citation omitted).

21/ Cf. Gordon Scott Venters, 51 S.E.C. 292, 294 (1993) (finding that applicant made a recommendation within the meaning of NASD Conduct Rule 2310 where customer's interest in investment was whetted by salesperson's and firm's promotional campaign); F.J. Kaufman and Co. of Va., 50 S.E.C. 164, 172 (1989) (finding that applicant made a recommendation within the meaning of the suitability rule where customers invested as a result of salesperson's substantial involvement and participation in the investment strategy).

22/ Maximo Justo Guevara, 54 S.E.C. 655, 662 (2000), petition denied, 47 Fed. Appx. 198 (3d Cir. 2002) (Table); Rafael Pinchas, 54 S.E.C. 331, 341 (1999); NASD Manual at 4261.

customers. 23/ The reasonableness of any recommendation is predicated on a registered representative's understanding of "the potential risks and rewards inherent in that recommendation." 24/ We have stated that "a broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for any investor, regardless of the investor's wealth, willingness to bear risk, age, or other individual characteristics." 25/

The record establishes, and Siegel does not dispute, that he had no basis, and certainly not a reasonable and adequate basis, for believing that his recommendations regarding an investment in World IEQ and World ET could be suitable for at least some customers. Siegel testified that he did not read any of the World IEQ and World ET documents that he provided to the Downers and the Landrys.

Even if Siegel had read them, he would not have had a reasonable basis for recommending World ET securities. Siegel admitted at the hearing that the World IEQ and World ET documents that he provided to the Downers and the Landrys were deficient: they either lacked or contained conflicting or confusing information about details that private placement transaction documents typically specify, such as maturity dates, interest rates, and repayment terms. Siegel agreed with a Panelist's comment at the hearing that the material provided to the Downers and the Landrys was "one of the worst sets of offering documents" he had ever seen and that "you can't tell what these people are investing in." During the exchange with the Panelist, Siegel further testified that, had he reviewed the documents, he "probably

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23/ Terry Wayne White, 50 S.E.C. 211, 212 & n.4 (1990) ("It is well established that a broker cannot recommend any security to a customer 'unless there is an adequate and reasonable basis for such recommendation,'" and "[a] broker cannot conclude that a recommendation is suitable for a particular customer unless he has a reasonable basis for believing that the recommendation could be suitable for at least some customers"); F.J. Kaufman and Co., 50 S.E.C. at 168 & n.16 (citing Hanley v. SEC, 415 F.2d 589, 597 (2d Cir. 1969) (a broker-dealer "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation")).

24/ F.J. Kaufman and Co., 50 S.E.C. at 168 & n.18 (citing Alexander Reid & Co., 40 S.E.C. 986, 990 (1962) (a broker's recommendation must be "responsibly made on the basis of actual knowledge and careful consideration"); Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Rel. No. 6721 (Feb. 2, 1962) ("the making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation")).

25/ See F.J. Kaufman and Co., 50 S.E.C. at 169-71 (finding recommendation unsuitable for any investor where registered representative was unaware of implications of investment strategy and therefore should not have recommended such strategy).

would have been discouraged with the company right then and there." Siegel also conceded at the hearing that the deficiencies in the documents rendered an investment in World IEQ and World ET unsuitable for the Downers, the Landrys, or any investor, particularly because there was no other information on which a prospective investor could rely to make an investment decision. 26/

Accordingly, we find that Siegel made unsuitable recommendations to the Downers and the Landrys in violation of NASD Conduct Rules 2310 and 2110.

IV.

Exchange Act Section 19(e) provides that we may cancel, reduce, or require the remission of a sanction imposed by NASD where we find, having due regard for the public interest and the protection of investors, that NASD's sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 27/ Siegel claims that NASD's sanction determinations were "result-driven" because NASD took "irreconcilable positions as to cases it previously decided" and "misappl[ied] the Sanction Guidelines in a way it had not previously applied them." As an initial matter, it is well established that "[b]ecause the selection of an appropriate sanction depends on the facts and circumstances of each particular case, action taken in other proceedings is not determinative." 28/ In this case, in view of the seriousness of Siegel's conduct, we believe that the sanctions imposed by NASD are neither excessive nor oppressive and that NASD properly applied the Sanction Guidelines.

A. Suspensions and Fines

1. NASD Conduct Rule 3040 Violations

NASD fined Siegel $20,000 and suspended him in all capacities for six months for having violated NASD Conduct Rules 3040 and 2110. NASD's Sanction Guidelines ("Sanction Guidelines") recommend a fine of $5,000 to $50,000 and a suspension of three to six months for

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26/ Because we have determined that Siegel did not have a reasonable basis for his recommendation of World ET, we do not address whether World ET was suitable for the Downers and the Landrys based upon their personal situations.

27/ 15 U.S.C. § 78s(e)(2). Siegel does not claim, and the record does not show, that NASD's action imposed an undue burden on competition.

28/ See Robin Bruce McNabb, 54 S.E.C. 917, 927 & n.38 (1999) (citing Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1976); Edward C. Farni II, 51 S.E.C. 1118, 1120 n.11 (1994)), aff'd, 298 F.3d 1126 (9th Cir. 2002).

selling-away violations involving sales totaling $100,000 to $500,000. 29/ The fine and suspension are within the recommended range. 30/

NASD identified several aggravating factors present in this case. Siegel sold $400,300 in World ET and World IEQ securities – an amount at the high end of the relevant range of $100,000 to $500,000. He was affiliated with World ET as a director and an employee. 31/ Siegel's sales of World ET and World IEQ securities injured his customers – who were customers of Rauscher. He attempted to conceal his sales activity by failing to inform Rauscher about his employment agreement with World ET and changing his address in the Notice Provision of his employment agreement with World ET, preventing Rauscher from discovering the extent of his involvement with the issuer. 32/ Siegel directly participated in the sales at issue. 33/

Siegel claims that he did not receive or expect financial benefit from his customers' investments. However, his activities on World ET's behalf had the potential for monetary or other gain from his roles at World ET as a director, creditor, and employee, as well as the potential of Rauscher's underwriting a future initial public offering.

29/ Sanction Guidelines at 15 (2006 ed.).

30/ The Sanction Guidelines have been promulgated by NASD in an effort to achieve greater consistency, uniformity, and fairness in the sanctions that are imposed for violations. Sanction Guidelines at 1. Since 1993, NASD has published and distributed the Sanction Guidelines so that members, associated persons, and their counsel will have notice of the types of disciplinary sanctions that may be applicable to various violations. Id. The Guidelines are not NASD rules that are approved by the Commission, but NASD-created guidance for NASD Adjudicators, which the Guidelines define as Hearing Panels and the National Adjudicatory Council. Id. Although the Commission is not bound by the Sanction Guidelines, it uses them as a benchmark in conducting its review under Exchange Act Section 19(e)(2).

31/ NASD further determined that, "[a]lthough Siegel disclosed to [the Downers] that he had applied to become a member of the World ET board of directors, he did not disclose to [the Landrys] that he had done so or that he had become a member of its board."

32/ See text following note 4 supra.

33/ Although Siegel claims that he did not sell World ET securities directly to the Downers and the Landrys, his conduct in connection with his customers' purchases, described at length above, evidences a significant involvement.

Contrary to Siegel's contention, he did not provide verbal notice of the details of his sales activities to his firm. 34/ Moreover, he ignored a warning from his firm not to sell World securities. Siegel argues that Rauscher's warning not to sell World ET securities applied "only if World were to go public." However, Siegel proffers no evidence in support of this assertion, and Rauscher made no such statement in its written permission for Siegel to become a director. Moreover, Siegel admitted at the hearing that Grandbouche informed him that it was highly unlikely that Rauscher would ever approve a sale of unregistered securities, such as World ET. In any event, Siegel is responsible for compliance with regulatory requirements and cannot shift his responsibility for compliance to his supervisors. 35/

We have held repeatedly that selling away is a serious violation. "Conduct Rule 3040 is designed not only to protect investors from unsupervised sales, but also to protect securities firms from liability and loss resulting from such sales. Such misconduct deprives investors of a firm's oversight, due diligence, and supervision, protections investors have a right to expect." 36/ Siegel sidestepped his firm's protections and supervision. Siegel's misconduct illustrates the potential for harm to public investors through private securities transactions. 37/

2. NASD Conduct Rule 2310 Violations

NASD fined Siegel $10,000 and suspended him in all capacities for six months for having violated NASD Conduct Rules 2310 and 2110 by making unsuitable recommendations to the Downers and the Landrys. The Sanction Guidelines recommend a fine of $2,500 to $75,000

34/ Siegel cites his testimony that he told his supervisor, Scott Grandbouche, that "these clients wanted to invest in World ET [and] do it on their own." However, Grandbouche testified that Siegel told him nothing about any of the transactions at issue. Even crediting Siegel's testimony, the information he conveyed lacks the required details of his sales activities, and, therefore, it does not constitute verbal notice to the firm. Cf. Chris Dinh Hartley, 57 S.E.C. 767, 775 (2004) (finding that failure to provide the firm with the necessary details about the investments and sales activities at issue was not verbal notice).

35/ See Philippe N. Keyes, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801 n.19 and accompanying text.

36/ Hartley, 57 S.E.C. at 776.

37/ See Anthony H. Barkate, 57 S.E.C. 488, 501 & n.28 (2004) (citing Ronald W. Gibbs, 52 S.E.C. 358, 365 (1995)), petition denied, 125 Fed. Appx. 892 (9th Cir. 2005) (Unpublished).

and a suspension of ten business days to one year or, in egregious cases, a suspension of up to two years or a bar. 38/ The suspension and fine are within this range.

NASD found aggravating that Siegel attempted to conceal his misconduct from his employer, that his misconduct resulted directly in injury to the Downers and the Landrys, and that his misconduct carried the potential for monetary or other gain.

NASD also found aggravating that Siegel's misconduct was the result of recklessness. We agree. 39/ At the time of the conduct at issue, Siegel was a securities professional with over seventeen years' experience. Yet, he testified that he neither read nor discussed with the Downers and the Landrys the contents of any of the World IEQ and World ET documents that he provided to them. He admitted at the hearing that these documents were deficient and that these deficiencies rendered an investment in World IEQ and World ET unsuitable for any investor.

In response to NASD's finding that he acted recklessly, Siegel claims that he did not act with fraudulent intent. However, Principal Consideration Number Thirteen under the Sanction Guidelines directs adjudicators to consider in all cases "[w]hether the respondent's misconduct was the result of an intentional act, recklessness or negligence." The applicability of this factor is not limited to proceedings involving fraud violations. 40/

38/ Sanction Guidelines at 99.

39/ Cf. RESTATEMENT (THIRD) OF TORTS § 2 (Proposed Final Draft 2005) ("A person acts recklessly in engaging in conduct if: (a) the person knows of the risk of harm created by the conduct or knows facts that make the risk obvious to another in the person's situation, and (b) the precaution that would eliminate or reduce the risk involves burdens that are so slight relative to the magnitude of the risk as to render the person's failure to adopt the precaution a demonstration of the person's indifference to the risk."); Oliver Wendell Holmes, THE COMMON LAW 135-36 (1881) ("The question is, what known circumstances are enough to throw the risk of a statement upon him who makes it, if it induces another man to act, and it turns out untrue. . . . Now what does 'recklessly' mean. It does not mean actual personal indifference to the truth of the statement. It means only that the data for the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. That is to say, . . . it means that the law, applying a general objective standard, determines that, if a man makes his statement on those data, he is liable, whatever was the state of his mind, and although he individually may have been perfectly free from wickedness in making it.")

40/ See generally Robert E. Strong, Exchange Act Rel. No. 57426 (Mar. 4, 2008), _ SEC Docket _ (considering whether chief compliance officer acted negligently or intentionally in allowing defective disclosures in research reports); Hans N. Beerbaum, Exchange Act Rel. No. 55731 (May 30, 2006), 90 SEC Docket 1863 (considering whether owner and (continued...)

Siegel argues that the "NAC's decision to jettison the Hearing Panel's credibility determination regarding his intent violates the rule of deference to fact-finders," and that the Hearing Panel's finding that he acted negligently "may be overcome only where the record contains substantial evidence for doing so." Siegel's arguments are without merit. The Hearing Panel did not make a credibility determination when it found that Siegel acted negligently. Thus, Siegel's state of mind and its mitigative effect are subject to the NAC's and our de novo review. 41/ The record provides ample support for finding that Siegel acted recklessly in making the unsuitable recommendations.

3. Siegel's Mitigation Claims

Siegel argues, as he did before the NAC, that there are a number of mitigating factors that justify a reduction in the sanctions imposed by NASD. We have discussed several of Siegel's assertions above and found them not supported. The remaining asserted mitigating factors fall into two general categories.

a. Siegel asserts that NASD improperly ignored "mitigating factors by considering them merely as 'non-aggravating.'" However, Siegel has failed to establish that the following group of factors, even if true, provides any mitigation. Siegel argues that his violation of NASD Conduct Rule 3040 "stemmed from his misunderstanding of it." We repeatedly have held that an associated person is obligated to be familiar with NASD's rules and ignorance of the requirements at issue is no excuse. 42/ Siegel's claimed misunderstanding of his obligation to comply with Conduct Rule 3040 is especially not mitigating because of his seventeen years of experience as an associated person in the securities industry and the fact that he has been active as a registered investment advisor, authored a book on investment advice, and served as a local media expert on financial topics. 43/

40/ (...continued)
president of member firm acted intentionally in engaging in conduct requiring registration as a general securities principal without being so registered).

41/ See supra notes 18 and 19.

42/ See Prime Investors, Inc., 53 S.E.C. 1, 5 & n.12 (1997) (finding a claimed ignorance of the law not mitigating).

43/ Cf. Keyes, 89 SEC Docket at 800 & n.18 (finding that associated person's claimed ignorance of his obligations regarding NASD Conduct Rule 3040 to be aggravating in light of his fifteen years of experience in the securities industry and the fact that he previously taught a preparatory class for the Series 6 qualification examination).

Siegel also asserts that he has no disciplinary history and that he cooperated in NASD's investigation. These facts are not mitigating because when Siegel registered with NASD, he agreed to abide by its rules, and compliance with this obligation is not a mitigating factor. 44/

Siegel asserts that he never performed any act pursuant to the World ET employment agreement, that the World ET securities have not been found to involve a violation of federal or state securities laws or federal, state, or self-regulatory organization rules, that he did not attempt to create the impression that Rauscher sanctioned the activity, and that he did not recruit other registered individuals to sell World ET securities. While the presence of any of these factors could constitute aggravating circumstances justifying an increase in sanctions, their absence is not mitigating. This is because an associated person should not be rewarded for acting in compliance with the securities laws and with his duties as a securities professional. 45/

b. NASD did find certain factors mitigating. Siegel argues that his recommendations were neither numerous nor made over an extended period of time, that the Downers and Landrys were "comparatively sophisticated persons who knew that they were risking money on a start-up enterprise with a new product," that a small number of customers were involved in the sales at issue, and that he disclosed to his customers that he was seeking an appointment to World ET's board. We agree with NASD that the mitigating impact of these factors is outweighed by the aggravating factors, especially given Siegel's failure to take steps to determine if investing in World ET was suitable for any investor.

Accordingly, we find that the mitigating factors raised by Siegel do not support a reduction in the sanction imposed by NASD.

4. Consecutive Suspensions

NASD ordered Siegel to serve the two six-month suspensions consecutively. In making this determination, NASD stated that "the purpose of sanctions in NASD disciplinary proceedings is to remedy misconduct" and that "in cases involving rule violations of fundamentally different natures, consecutive suspensions specifically discourage all types of

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44/ See Michael A. Rooms, Exchange Act Rel. No. 51467 (Apr. 1, 2005), 85 SEC Docket 444, 450-51 (finding sanction neither oppressive nor excessive where respondent noted a lack of disciplinary history), aff'd, 444 F.3d 1208, 1214 (10th Cir. 2006); Keyes, 89 SEC Docket at 801 & nn. 20, 22 (finding cooperation during NASD investigation and a lack of disciplinary history not mitigating) (citing cases); Michael Markowski, 51 S.E.C. 553, 557 (1993), aff'd, 34 F.3d 99 (3d Cir. 1994). The Guidelines provide that an associated person's "substantial assistance" to NASD during an investigation is generally mitigating. Siegel's cooperation was consistent with the responsibility he agreed to fulfill when he became an associated person and does not constitute substantial assistance.

45/ See Keyes, 89 SEC Docket at 801 & n.20.

additional misconduct at issue." NASD noted that "consecutive suspensions might exceed what is needed to be remedial, depending on the facts and circumstances." NASD suggested that, where the underlying violations involved wholly unintentional or negligent conduct and similar violations resulted from the same underlying conduct, concurrent suspensions "might be enough to alert such a respondent about his various regulatory responsibilities and deter him from again engaging in the same kinds of violative conduct." 46/ However, NASD concluded that consecutive suspensions were necessary to discourage Siegel's misconduct "because his selling away and suitability violations involve different kinds of misconduct and raise separate and serious regulatory concerns."

Siegel argues that the imposition of consecutive suspensions is punitive because his violations involved the "same underlying conduct" and should therefore have resulted in "batching," or concurrent suspensions. We have not previously addressed whether the imposition of consecutive – as opposed to concurrent – suspensions is excessive or oppressive. We agree with NASD that Siegel's violations are different in nature and raise separate public interest concerns. The purpose of NASD Conduct Rule 3040 is to protect "investors from unsupervised sales and securities firms from exposure to loss and litigation from transactions by associated persons outside the scope of their employment." 47/ The suspension will protect the public interest by discouraging Siegel and others from selling away and from undermining the protections in place at firms. 48/ In contrast, the purpose of the suitability rule is to protect customers from potentially abusive sales practices by ensuring that a registered representative has reasonable grounds for believing that his recommendation is suitable. 49/ The second suspension will protect the public interest by encouraging Siegel and others to take the steps necessary to

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46/ General Principle Four of the Sanction Guidelines also discusses when the aggragation or "batching" of violations may be appropriate if (a) the violative conduct was unintentional or negligent; (b) the conduct did not result in injury to public investors; or (c) the problem resulted from a single systemic problem or cause that has been remedied. General Principle Four also states that multiple violations may be treated individually "[d]epending on the facts and circumstances of a case."

47/ See Hartley, 57 S.E.C. at 775 n.17 (citation omitted).

48/ See Hartley, 57 S.E.C. at 776 (affirming suspension for violation of NASD Conduct Rule 3040).

49/ See Self-Regulatory Organizations; NASD; Order Granting Approval to Proposed Rule Change, Exchange Act Rel. No. 37588 (Aug. 20, 1996), 62 SEC Docket 1784, 1795 ("The concept of suitability, rooted in notions of just and equitable principles of trade and the protection of investors, plays an important role in the scheme of the federal securities laws. Prohibitions against making unsuitable recommendations . . . lay the foundation for good and sound business practices by broker-dealers and help avoid potential abusive sales practices regarding customers.")

determine that recommendations that they make to their customers are suitable while also deterring them from putting their own interests ahead of those of their customers. 50/ Under the circumstances and with due regard for the public interest and the protection of investors, we find that NASD's imposition of two consecutive six-month suspensions with respect to the violations found here does not exceed what is needed to be remedial and therefore is not excessive or oppressive. 51/

* * *

Accordingly, we find that the suspensions and fines serve a remedial purpose and that Siegel has failed to identify any mitigating factors that support a reduction in these sanctions.

B. Restitution

NASD ordered restitution to the customers at issue in the amount of $400,300. Siegel attempts to import common law equity principles to an analysis of NASD's restitution award. However, NASD's authority to order restitution arises not from common law but from its power to impose "any other fitting sanction." 52/ As a result, Siegel's contentions with respect to judicially assessed restitution are inapposite.

For example, Siegel argues that an award of restitution is inappropriate because he did not cause the customers' losses but only caused them to invest. Siegel relies on Bastian v. Petren Resources Corp.. 53/ However, Bastian was a private action for damages under the antifraud provisions of the federal securities laws where "loss causation" was an element of the claim.

In contrast, we have stated that self-regulatory organization "[r]estitution is founded on the principle that a wrongdoer shall not be unjustly enriched by his wrongdoing, or that the

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50/ Cf. McNabb, 54 S.E.C. at 928 & n.41 (1999) (finding that associated person put his own interests ahead of those of his customers by making unsuitable recommendation that they purchase promissory notes to give him money to use in his business).

51/ See PAZ Sec., Inc., Exchange Act Rel. No. 57656 (Apr. 11, 2008), __ SEC Docket __, __ (finding sanction to be remedial and therefore neither excessive nor oppressive), appeal docketed, No. 08-1188 (D.C. Cir. May 13, 2008).

52/ NASD Rule 8310(6), NASD Manual at 7271.

53/ 892 F.2d 680 (7th Cir. 1990).

wrongdoer should restore his victim to the status quo ante." 54/ To that end, we have expressed "our preference that the NASD issue orders of restitution, in contrast to fines payable to the NASD, in instances in which losses have been suffered by identifiable customers as a result of a respondent's misconduct." 55/ Our decision in David Joseph Dambro 56/ anticipated the possibility that, under certain circumstances, restitution may be an appropriate remedy where an identifiable person has suffered a loss as a result of a registered representative's recommendation. As we stated in Dambro, 57/ as between Siegel's customers, who were placed in unsuitable investments and Siegel, who recommended them, equity requires Siegel, as the person responsible for the losses, to bear their burden and to return the customers to the position occupied prior to the unsuitable recommendations. The current Sanction Guidelines recommend restitution "where necessary to remediate misconduct" and when an identifiable person "has suffered a quantifiable loss as a result of a respondent's misconduct." 58/

Here, Siegel introduced the Downers and the Landrys to World ET, recommended without any basis that they invest in the company, was their sole source of information about the company prior to making their investment decisions, and facilitated their purchases of World ET securities. Given that Siegel was the first to identify World ET to the customers and the significance of Siegel's involvement and influence in the decision of the customers to invest in World ET, we conclude that the customers' losses were a result of his recommendations. We therefore reject Siegel's argument.

54/ Toney L. Reed, 51 S.E.C. 1009, 1013 & nn.15, 16 (1994) (citing RESTATEMENT OF RESTITUTION § 1 (1937)); see also David Joseph Dambro, 51 S.E.C. 513, 518 (1993).

55/ Toney L. Reed, 52 S.E.C. 944, 946 & n.11 (1996) (emphasis added) (citing Dambro, 51 S.E.C. at 518-19). In requiring that a loss be a result rather than the result of a respondent's misconduct, we acknowledge that other factors may bear upon the loss and that any determination as to the propriety of restitution will be based on an analysis of all the relevant facts and circumstances.

56/ 51 S.E.C. 513 (1993).

57/ 51 S.E.C. at 518-19 ("As between Wiegman, who was placed in an unsuitable investment and Dambro, who recommended it, equity requires Dambro, as the person responsible for the loss, to bear its burden and to return the customer to the position occupied prior to the improper recommendation.").

58/ Sanction Guidelines at 4 ("Adjudicators may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss as a result of a respondent's misconduct, particularly where a respondent has benefitted from the misconduct."); see also Wendell D. Belden, 56 S.E.C. 496, 507 (2003).

Siegel argues that restitution is not appropriate because he received no monetary gain. We have repeatedly stated, however, that restitution does not require that an applicant have profited or benefitted from his actions. 59/ Sanction Guidelines General Principle Five also provides that NASD orders of restitution may exceed the amount of the respondent's ill-gotten gain. 60/

Siegel asserts that the customers should not receive restitution because they knew the risks associated with their investment and were sophisticated. As a result, Siegel claims that he did not cause their losses. Even where a customer seeks to engage in a highly speculative investment, a registered representative has a duty to refrain from making unsuitable recommendations. 61/ Siegel did not satisfy this duty. Instead, he made reckless recommendations to customers who relied on his financial advice.

Siegel claims that the Downers and the Landrys are guilty of laches and violation of the statute of limitations. He asserts that they delayed in bringing an arbitration against Siegel, which, in turn, delayed the initiation of the current proceeding. Siegel also claims the customers are guilty of unclean hands because Huntington Downer's law firm threatened Siegel with criminal prosecution. However, the party in this proceeding is NASD, not the customers. Whether the customers were estopped by laches or a statute of limitations from pursuing an arbitration proceeding does not affect NASD's ability to discipline associated persons of its members, including imposing a "fitting sanction" for that person's wrongful conduct.

Siegel argues that he was prejudiced by the alleged delay because he was unable to call three now deceased or ill customers who would have testified that Siegel had not recommended World ET securities to them. This testimony, however, has no bearing on whether Siegel recommended World ET securities to the Downers and the Landrys. 62/ This testimony also

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59/ See Franklin N. Wolf, 52 S.E.C. 517, 526 (1995); Toney L. Reed, 51 S.E.C. at 1013-14.

60/ Sanction Guidelines General Principle Five.

61/ See Jack H. Stein, 56 S.E.C. 108, 113 & n.14 (2003) (finding that a registered representative is under a duty to refrain from making unsuitable recommendations even where a customer affirmatively seeks to engage in highly speculative trading) (citations omitted).

62/ Cf. Gluckman, 54 S.E.C. at 190-91 (finding that applicant suffered no prejudice from inability to examine witness during an NASD hearing due to passage of time where testimony of the witness would not have a had a material effect on the proceeding).

would not mitigate Siegel's misconduct with respect to the Downers and Landrys. 63/ Siegel also claims that he was unable to produce certain records but does not identify the substance or relevance of those records. Thus, Siegel has not demonstrated that he suffered any prejudice.

Siegel claims that NASD acted unfairly when it failed to hold an in-person hearing regarding whether the restitution amount required offset. Siegel does not dispute that there is no offset under the three factors set forth by the NAC, i.e., the Downers and the Landrys did not sell their investments in World securities, their World securities have no residual value, and they recovered no restitution through other avenues. Yet, Siegel contends that an in-person hearing was required so that he could present evidence of the "customers' expectations [of recovery and] measures of their reasonable expectations" and demonstrate the prejudice that he allegedly suffered due to the customers' purported "undue delay in . . . voicing complaint." However, this evidence goes to whether restitution was an appropriate sanction, a determination that had been resolved in the initial in-person hearing at which Siegel had the opportunity to, and did, examine and cross-examine witnesses and present evidence. While Siegel also contends that an in-person hearing was required so that he could cross-examine the affiants, it is unclear what purpose cross-examination would have served, because Siegel did not dispute the affiants' testimony that there was no offset to the restitution award. 64/

63/ Cf. Dane S. Faber, 57 S.E.C. 297, 313 n.33 (2004) (finding that failure to engage in other violative conduct did not mitigate violations at issue); Richmark Capital Corp., 57 S.E.C. 1, 18 (2003) (finding that failure to engage in misconduct "that was arguably more serious" did not mitigate violations at issue).

64/ We are unpersuaded by Siegel's citation to SEC v. Smyth, 420 F.3d 1225 (11th Cir. 2005), in support of his argument that an evidentiary hearing was required. In Smyth, the court acknowledged that an evidentiary hearing is not always required to determine the appropriate amount of a sanction. It found that, under the particular circumstances of the case, the trial court improperly denied an evidentiary hearing because the appellant had explicitly reserved in a written settlement agreement the right to litigate the amount of disgorgement and prejudgment interest, which had not yet been determined and could potentially have amounted to zero if certain of the appellant's claims about the undetermined amount were true. Such circumstances do not exist here.

Siegel complains that the NAC increased his sanctions when it ordered restitution where the Hearing Panel did not, rendering this aspect of the sanction determination punitive and unfair. Here, the NAC found that the Hearing Panel improperly concluded that the pending arbitration proceeding foreclosed restitution. We have stated that the "NASD procedural rules expressly permit the NAC, where appropriate, to 'affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction.'" 65/

On the basis of the record in this proceeding, we do not find these sanctions either excessive or oppressive.

An appropriate order will issue. 66/

By the Commission (Chairman COX and Commissioners CASEY and PAREDES), Commissioners WALTER and AGUILAR not participating.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

65/ See Abbondante, 87 SEC Docket at 224 & n.71 (citing NASD Code of Procedure Rule 9348, NASD Manual at 7371).

66/ 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

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 58737 / October 6, 2008

Admin. Proc. File No. 3-12659

In the Matter of the Application of

MICHAEL FREDERICK SIEGEL
c/o George C. Freeman, III
Barrasso Usdin Kupperman Freeman & Sarver, LLC
909 Poydras Street, Suite 2400
New Orleans, Louisiana 70112

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

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

ORDERED that the disciplinary action taken by NASD against Michael Frederick Siegel, and NASD's assessment of costs be, and they hereby are, sustained.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-8975; 34-58747; File No. 4-573]

SEC Study of Mark to Market Accounting

AGENCY: Securities and Exchange Commission..

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission is requesting public comment related to the study to be conducted by the Commission under the Emergency Economic Stabilization Act of 2008 of "mark-to-market" accounting applicable to financial institutions, including depository institutions.

DATES: Comments should be received on or before [insert 30 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/other.shtml); or

• Send an e-mail message to rule-comments@sec.gov. Please include File Number 4-573 on the subject line.

Paper Comments

• Send paper comments in triplicate to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. 4-573. 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 its 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, on official business days between the hours of 10:00 am and 3:00 pm. 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: Jenifer Minke-Girard, Senior Associate Chief Accountant, at (202) 551-5300, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6561.

SUPPLEMENTARY INFORMATION: In connection with the study to be conducted by the Securities and Exchange Commission ("Commission") under the Emergency Economic Stabilization Act of 2008 (the "Act")[1] of "mark-to-market" accounting applicable to financial institutions, including depository institutions, the Commission welcomes public comments on the issues, point-of-view, research and opinions that the Commission's staff should consider in conducting the study.

The Act, which was enacted and signed by the President on October 3, 2008, requires the Commission to conduct a study of "mark-to-market" accounting and submit a report to Congress with the findings and determinations within 90 days. Specifically Section 133 of the Act provides as follows:

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[1] H.R. 1424.

STUDY ON MARK-TO-MARKET ACCOUNTING.

(a) STUDY.—The Securities and Exchange Commission, in consultation with the Board [of Governors of the Federal Reserve System] and the Secretary [of the Treasury], shall conduct a study on mark-to-market accounting standards as provided in Statement Number 157 of the Financial Accounting Standards Board, as such standards are applicable to financial institutions, including depository institutions. Such a study shall consider at a minimum—

(1) the effects of such accounting standards on a financial institution's balance sheet;

(2) the impacts of such accounting on bank failures in 2008;

(3) the impact of such standards on the quality of financial information available to investors;

(4) the process used by the Financial Accounting Standards Board in developing accounting standards;

(5) the advisability and feasibility of modifications to such standards; and

(6) alternative accounting standards to those provided in such Statement Number 157.

(b) REPORT.—The Securities and Exchange Commission shall submit to Congress a report of such study before the end of the 90-day period beginning on the date of the enactment of this Act containing the findings and determinations of the Commission, including such administrative and legislative recommendations as the Commission determines appropriate

All interested parties are invited to submit their views, in writing, on any or all of the subjects identified, whether subjects in addition to those identified should be included in the study for any reason or on any other matter relating to the current use of fair value accounting (including mark-to-market) in the U.S. financial reporting system that should be considered.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 8, 2008

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2797 / October 8, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13271

In the Matter of

Sterling Capital Planners, Inc.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) 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(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Sterling Capital Planners, Inc. ("Sterling" 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, and the findings contained in Section III.1 and III.3 below, which are admitted, Respondent, through its Court-appointed Receiver, Arthur Steinberg, Esq., consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.[1]

[1] The provisions of this Order apply to the Respondent and not to the Receiver as the person administering the receivership estate.

III.

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

1. Sterling is a registered investment adviser. Until February 2007, Sterling's principal place of business was 110 East 55th Street, New York, New York. On February 9, 2007, the Commission filed an emergency injunctive action against Sterling and its principal Ravi Kothare, and other Kothare owned entities, seeking, among other relief, the appointment of a receiver. SEC v. Kothare, et al., 07 Civ. 954 (LTS) (S.D.N.Y.) Arthur A. Steinberg was appointed as Receiver for Sterling on February 9, 2007.

2. At the time that the Commission commenced the action against Sterling, it held approximately $39 million in assets under management. Assets under management have now been returned to Sterling's clients by the Receiver. Prior to the appointment of the Receiver, Sterling was owned and controlled by Ravi Kothare, who died on March 8, 2007.

3. On October 1, 2008, a final judgment was entered by consent against Sterling permanently enjoining it 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 Sections 206(1), 206(2), 206(4) and 207 of the Investment Advisers Act of 1940 and Rules 204-2 and 206(4)-2 thereunder, in the civil action entitled SEC v. Kothare, et al., 07 Civ. 954 (LTS) (S.D.N.Y.), in the United States District Court for the Southern District of New York.

4. The Commission's complaint alleged that, in connection with the sale of interests in a limited liability company, Sterling misused and misappropriated investor funds, falsely stated to investors that their funds were invested, sent out false account statements indicating that investors funds were fully invested and earning returns, failed to maintain subscription agreements, maintained forged subscription agreement signature pages, and otherwise engaged in a variety of conduct which operated as a scheme to fraud and deceive Sterling's clients, who had invested in Players Choice Club, LLC ("Players Choice"), a limited liability company controlled by Kothare. The Complaint further alleged that Kothare and Sterling undertook these acts while in custody or possession of funds or securities, in which clients had a beneficial interest, that had not been verified by actual examination at least once during each calendar year by an independent public accountant at a time chosen by the accountant without prior notice to Kothare and Sterling. Specifically, Sterling misappropriated at least $1.85 million from 18 Sterling investment advisory clients and invested nearly all of this money in Players Choice. In breach of his fiduciary duty, Kothare transferred Sterling clients' funds to Players Choice without obtaining the clients' written consent and without disclosing significant conflicts of interest. At some point, Kothare disclosed the "investments" in Players Choice on the clients' Sterling account statements, but he failed to disclose that he controlled Players Choice. The account statements also reflected a "market value" for the Players Choice investment, even though the investment was illiquid and had no market value. The market value that Kothare

disclosed in the account statements was set by Kothare with no reasonable basis and falsely portrayed the investment as having maintained or even increased in value, when, in fact, Players Choice had become essentially worthless. Among other things, Sterling failed to disclose to investors that Players Choice lost its most significant asset – a two-year license from the Major League Baseball Players Association that was critical to its business. Having lost its license, Players Choice had no saleable assets or revenues.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(e) of the Advisers Act, that Respondent's registration as an investment adviser be, and hereby is, revoked.

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58750 / October 8, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13272

In the Matter of JEREMY D. JOBE, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Jeremy D. Jobe ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Jobe, age 31, is a resident of Dallas, Texas. He formerly served as Director of Investor Relations for Telomolecular Corp. ("Telomolecular") and in that position he sold Telomolecular stock on commission for proceeds of approximately $2.5 million. During 2000-2004 he was employed as a registered representative for broker-dealers registered with the Commission, but he was not associated with any registered broker-dealer or himself registered with the Commission for his sales of Telomolecular stock.

2. On September 30, 2008, a final judgment was entered by consent against Jobe, permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Matthew A. Sarad, et. al, Civil Action Number 2:08-cv-02252-GEB-DAD, in the United States District Court for the Eastern District of California.

3. The Commission's complaint alleged that Jobe offered and sold securities in the form of Telomolecular stock while no registration statement was on file or in effect as to the offers and sales and while he was not registered with the Commission as a broker or dealer or associated with an entity registered with the Commission as a broker or dealer

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent Jobe be, and hereby is barred from association with any broker or dealer with the right to reapply for association after three 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.

Florence E. Harmon
Acting 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
Rel. No. 58756 / October 8, 2008

INVESTMENT COMPANY ACT OF 1940
Rel. No. 28436 / October 8, 2008

Admin. Proc. File No. 3-12753

In the Matter of

JOSEPH JOHN VANCOOK

c/o Lewis D. Lowenfels, Esq.
Law Offices of Tolins & Lowenfels
747 Third Avenue
New York, New York 10017

Michael J. Sullivan, Esq
Coughlin Duffy LLP
350 Mount Kemble Avenue
P.O. Box 1917
Morristown, New Jersey 07962

ORDER GRANTING PARTIAL PROTECTIVE ORDER

On August 27, 2008, Joseph John VanCook submitted income tax returns ("the Confidential Information"), in connection with his petition for review of an administrative law judge's initial decision and requested a protective order limiting disclosure of such information. Under Rule of Practice 322, any party "may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information." 1/ The rule further provides that "[a] motion for protective order shall be granted only upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure." 2/ The Division of Enforcement has not opposed VanCook's request for a protective order.

The Commission has long emphasized the importance of conducting open administrative proceedings that, "with attendant public scrutiny, have the effect of protecting against the abuse

1/ 17 C.F.R. § 201.322(a).

2/ 17 C.F.R. § 201.322(b).

of power by governmental entities." 3/ Commission administrative proceedings, and the documents filed by parties pursuant to those proceedings, generally are accessible to the public unless the circumstances warrant a departure from the norm in accordance with our Rules of Practice. 4/ The documents VanCook has submitted are tax returns that contain sensitive financial information, and, at this stage in the proceeding, the harm resulting from complete disclosure appears to outweigh the benefits. 5/ However, because disclosure of portions of the Confidential Information will be necessary to our consideration of this proceeding, we shall grant the requested protective order subject to certain limitations. 6/

Accordingly, IT IS ORDERED that:

1. Except as otherwise provided in this Order, the Confidential Information shall be disclosed only to the parties to this proceeding, their counsel, the Commission, any staff advising the Commission in its deliberative processes with respect to this proceeding and, in the event of an appeal of the Commission's determination, any staff acting for the Commission in connection with that appeal.

3/ Dominic A. Alvarez, Securities Exchange Act Rel. No. 53231 (Feb. 6, 2006), 87 SEC Docket 985, 985 n.3 (quoting Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, 53 Fed. Reg. 26427, 26428-29 (July 13, 1988)).

4/ Alvarez, 87 SEC Docket at 985 n.4.

5/ See Thomas C. Bridge, Securities Act Rel. No. 8952 (Aug. 7, 2008), __ SEC Docket ____ (granting request for order protecting personal financial information in connection with petition for review and noting that the "harm resulting from complete disclosure outweighs the benefits"); James D. Edge, Exchange Act Rel. No. 58062 (June 30, 2008), __ SEC Docket ____ (same); Jeffrey K. Robles, Exchange Act Rel. No. 58063 (June 30, 2008), __ SEC Docket ____ (same); Gregory O. Trautman, Exchange Act Rel. No. 57475 (Mar. 11, 2008), 92 SEC Docket 3172 (same).

6/ See Bridge, __ SEC Docket at ____ (determining that disclosure of certain information included in the documents at issue was necessary to the Commission's consideration of the proceeding); Edge, __ SEC Docket at ____ (same); Robles, __ SEC Docket at ____ (same); Trautman, 92 SEC Docket at 3172 (same); Kevin Hall, CPA, Exchange Act Rel. No. 56242 (Aug. 13, 2007), 91 SEC Docket 1071, 1072 (same); David Henry Disraeli, Exchange Act Rel. No. 56012 (July 5, 2007), 90 SEC Docket 3175, 3175 (same). We note that our determination to grant protective status to the Confidential Information should not be construed as a determination to admit such information into the record.

2. All persons who receive access to the Confidential Information shall keep it confidential and, except as provided in this Order, shall not divulge the Confidential Information to any person.

3. No person to whom the Confidential Information is disclosed shall make any copies or otherwise use such Confidential Information, except in connection with this proceeding or any appeal thereof.

4. The Office of the Secretary shall place the Confidential Information in sealed envelopes or other sealed containers marked with the title of this action, identifying each document and marked "CONFIDENTIAL."

5. The requirements of sealing and confidentiality shall not apply to any reference to the existence of the documents or to citation of particular information contained therein in testimony, oral argument, briefs, opinions, or in any other similar use directly connected with this action or any appeal thereof.

6. The Commission expressly reserves the authority to reach a different conclusion regarding the protective status of any portion of the Confidential Information covered by this Order at any time before it determines the issues raised in the proceeding.

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33-8976, 34-58769; File No. S7-14-08]

RIN 3235-AK16

INDEXED ANNUITIES AND CERTAIN OTHER INSURANCE CONTRACTS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; reopening of comment period.

SUMMARY: The Securities and Exchange Commission is reopening the period for public comment on new rules that it originally proposed in Securities Act Release No. 8933 (June 25, 2008) [73 FR 37752 (July 1, 2008)]. The Commission proposed a rule that would, if adopted, define the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933. The proposed rule is intended to clarify the status under the federal securities laws of indexed annuities. The Commission also proposed to exempt insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities that are registered under the Securities Act, provided that the securities are regulated under state insurance law, the issuing insurance company and its financial condition are subject to supervision and examination by a state insurance regulator, and the securities are not publicly traded.

DATES: 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:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-14-08 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 Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-14-08. 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). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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: Keith E. Carpenter, Senior Special Counsel, Office of Disclosure and Insurance Product Regulation, Division of Investment

Management, at (202) 551-6795, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is reopening the period for public comment on a proposed rule that would define the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933. The proposed rule is intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index. The Commission is also reopening the period for public comment on a proposed rule that would, if adopted, exempt insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities that are registered under the Securities Act, provided that the securities are regulated under state insurance law, the issuing insurance company and its financial condition are subject to supervision and examination by a state insurance regulator, and the securities are not publicly traded. The rules were proposed on June 25, 2008,[1] and the comment period initially closed on September 10, 2008.

The Commission has received numerous letters, including from state insurance commissioners, members of Congress, and others, requesting that the comment period be extended.[2] In general, these commenters indicated that an extension would help them

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1 Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release No. 8933 (June 25, 2008) [73 FR 37752 (July 1, 2008)].

2 Comments on the proposal are available at www.sec.gov/comments/s7-14-08/s71408.shtml.

analyze the proposal and prepare meaningful comments. In order to provide additional time for the public to thoroughly consider the proposal, and in view of the significant continuing public interest in the proposal, the Commission believes that it is appropriate to reopen the comment period. Accordingly, we will reopen the comment period for an additional 30 days.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

October 10, 2008

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-58773; File No. S7-30-08]

RIN 3235-AK22

Amendments to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; request for comments.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting an interim final temporary rule under the Securities Exchange Act of 1934 ("Exchange Act") to address abusive "naked" short selling in all equity securities by requiring that participants of a clearing agency registered with the Commission deliver securities by settlement date, or if the participants have not delivered shares by settlement date, immediately purchase or borrow securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the day the participant incurred the fail to deliver position. Failure to comply with the close-out requirement of the temporary rule is a violation of the temporary rule. In addition, a participant that does not comply with this close-out requirement, and any broker-dealer from which it receives trades for clearance and settlement, will not be able to short sell the security either for itself or for the account of another, unless it has previously arranged to borrow or borrowed the security, until the fail to deliver position is closed out.

DATES: Effective Date: October 17, 2008 except §242.204T is effective October 17, 2008 until July 31, 2009.

Comment Date: 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/final.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-30-08 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 Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-30-08. 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/final.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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: James A. Brigagliano, Associate Director, Josephine J. Tao, Assistant Director, Victoria L. Crane, Branch Chief, Joan M. Collopy, Special

Counsel, Christina M. Adams and Matthew Sparkes, Staff Attorneys, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION: We are adopting temporary Rule 204T of Regulation SHO [17 CFR 242.204T] as an interim final temporary rule. We are soliciting comments on all aspects of the rule. We will carefully consider the comments that we receive and intend to respond to them in a subsequent release.

I. Introduction

Recently, we have become concerned that there is a substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. These concerns with respect to financial institutions are evidenced by our recent publication of emergency orders under Section 12(k) of the Exchange Act in July (the "July Emergency Order")[1] and September of this year (the "Short Sale Ban Emergency Order").[2] In these orders we noted our concerns about the possible use of unfounded rumors regarding the stability of financial institutions by short sellers for the purpose of manipulating the prices of securities issued by the financial institutions to increase profits through "naked" short selling.[3]

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1 See Exchange Act Release No. 58166 (July 15, 2008), 73 FR 42379 (July 21, 2008) (imposing borrowing and delivery requirements on short sales of the equity securities of certain financial institutions).

2 See Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008) (temporarily prohibiting short selling in the publicly traded securities of certain financial institutions); see also Exchange Act Release No. 58611 (Sept. 21, 2008), 73 FR 55556 (Sept. 25, 2008) (amending the Short Sale Ban Emergency Order).

3 "Naked" short selling generally refers to selling short without having borrowed the securities to make delivery. See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48009 n.10 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release"); see also Commission press release, dated July 13, 2008, announcing that the Commission's Office of Compliance Inspections and Examinations, as well as the Financial Industry Regulatory Authority ("FINRA") and New York Stock Exchange Regulation, Inc., ("NYSE") will immediately conduct examinations aimed at the prevention of the intentional spreading of false information intended to manipulate securities prices. See http://www.sec.gov/news/press/2008/2008-140.htm. In addition, in April of

Our concerns, however, are not limited to just the financial institutions that were the subject of the July Emergency Order and the Short Sale Ban Emergency Order. Given the importance of confidence in our financial markets as a whole, we have become concerned about sudden and unexplained declines in the prices of equity securities generally. Such price declines can give rise to questions about the underlying financial condition of an institution, which in turn can create a crisis of confidence even without a fundamental underlying basis. This crisis of confidence can impair the liquidity and ultimate viability of an institution, with potentially broad market consequences. These concerns resulted in our issuance on September 17 of this year of an emergency order under Section 12(k) of the Exchange Act (the "September Emergency Order").[4] Pursuant to that emergency order we imposed enhanced delivery requirements on sales of all equity securities by adding and making immediately effective a temporary rule to Regulation SHO, Rule 204T.[5]

To further our goal of preventing substantial disruption in the securities markets, we are adopting Rule 204T as an interim final temporary rule, with some modifications to address operational and technical concerns resulting from the requirements of the temporary rule as adopted in the September Emergency Order. We intend that the temporary rule will address potentially abusive "naked" short selling by requiring that securities be purchased or borrowed to close out any fail to deliver position in an equity security by no later than the beginning of

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this year, the Commission charged Paul S. Berliner, a trader, with securities fraud and market manipulation for intentionally disseminating a false rumor concerning The Blackstone Group's acquisition of Alliance Data Systems Corp ("ADS"). The Commission alleged that this false rumor caused the price of ADS stock to plummet, and that Berliner profited by short selling ADS stock and covering those sales as the false rumor caused the price of ADS stock to fall. See http://www.sec.gov/litigation/litreleases/2008/lr20537.htm.

4. See Exchange Act Release No. 58572 (Sept. 17, 2008), 73 FR 54875 (Sept. 23, 2008).

5. See id. The September Emergency Order also made immediately effective amendments to Rule 203(b)(3) of Regulation SHO that eliminate the options market maker exception from Regulation SHO's close-out requirement. It also made immediately effective Rule 10b-21, a "naked" short selling antifraud rule.

regular trading hours on the settlement day following the date on which the fail to deliver position occurred. This temporary rule should provide a powerful disincentive to those who might otherwise engage in potentially abusive "naked" short selling.

II. Background

Short selling involves a sale of a security that the seller does not own or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.[6] Short sales normally are settled by the delivery of a security borrowed by or on behalf of the seller. In a "naked" short sale, however, the short seller does not borrow securities in time to make delivery to the buyer within the standard three-day settlement period.[7] As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "fail" or "fail to deliver").[8] Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security,[9] or possibly to avoid borrowing costs associated with short sales, especially when the costs of borrowing stock are high.

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6 17 CFR 242.200(a).

7 See 2004 Regulation SHO Adopting Release, 69 FR at 48009 n.10.

8 Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next settlement day following the trade (or T+1). In addition, Rule 15c6-1 prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. 17 CFR 240.15c6-1; Exchange Act Release No. 33023 (Oct. 7, 1993), 58 FR 52891 (Oct. 13, 1993). However, failure to deliver securities on T+3 does not violate Rule 15c6-1; see also Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544, n. 2 (Aug. 14, 2007) ("2007 Regulation SHO Final Amendments").

9 In 2003, the Commission settled a case against certain parties relating to allegations of manipulative short selling in the stock of a corporation. The Commission alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the stock, and depressed its price. See Rhino Advisors, Inc. and Thomas Badian, Lit. Rel. No. 18003 (Feb. 27, 2003); see also SEC v. Rhino Advisors, Inc. and Thomas Badian, Civ. Action No. 03 civ 1310 (RO) (S.D.N.Y); see also Exchange Act Release No. 48709

Although the majority of trades settle within the standard three-day settlement cycle ("T+3"),[10] we adopted Regulation SHO[11] on July 28, 2004, in part to address problems associated with persistent fails to deliver securities and potentially abusive "naked" short selling. For example, Regulation SHO requires broker-dealers to "locate" securities that the broker-dealer reasonably believes can be delivered within the standard three-day settlement period.[12]

Another requirement of Regulation SHO aimed at potentially abusive "naked" short selling and reducing fails to deliver in certain equity securities is the rule's "close-out" requirement. Specifically, Rule 203(b)(3) requires participants[13] of a registered clearing agency,[14] which includes broker-dealers, to purchase shares to close out fails to deliver in

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(Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) ("2003 Regulation SHO Proposing Release") (describing the alleged activity in the case involving stock of Sedona Corporation); 2004 Regulation SHO Adopting Release, 69 FR at 48016, n.76.

10 According to the National Securities Clearing Corporation ("NSCC"), 99% (by dollar value) of all trades settle within T+3. Thus, on an average day, approximately 1% (by dollar value) of all trades, including equity, debt, and municipal securities fail to settle on time.

11 17 CFR 242.200. Regulation SHO became effective on January 3, 2005.

12 17 CFR 242.203(b)(1). Rule 203(b)(1) of Regulation SHO requires that, "A broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1)." This is known as the "locate" requirement. Market makers engaged in bona fide market making in the security at the time they effect the short sale are excepted from this requirement.

13 For purposes of Regulation SHO, the term "participant" has the same meaning as in section 3(a)(24) of the Exchange Act. See 15 U.S.C. 78c(a)(24).

14 The term "registered clearing agency" means a clearing agency, as defined in Section 3(a)(23)(A) of the Exchange Act, that is registered as such pursuant to Section 17A of the Exchange Act. See 15 U.S.C. 78c(a)(23)(A) and 78q-1, respectively; see also 2004 Regulation SHO Adopting Release, 69 FR at 48031. The majority of equity trades in the United States are cleared and settled through systems administered by clearing agencies registered with the Commission. The National Securities Clearing Corporation ("NSCC") clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter market. NSCC clears and settles trades through the Continuous Net Settlement ("CNS") system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of their securities delivery and payment obligations daily. In addition, NSCC guarantees the completion of all transactions and interposes itself as the contraparty to both sides of the transaction.

securities with large and persistent fails to deliver, i.e., "threshold securities."[15] Until the position is closed out, the participant responsible for the fail to deliver position and any broker-dealer from which it receives trades for clearance and settlement may not effect further short sales in that threshold security without first borrowing or arranging to borrow the securities.[16]

As adopted, Regulation SHO included two major exceptions to the close-out requirement: the "grandfather" provision and the "options market maker" exception. The "grandfather" provision had provided that fails to deliver established prior to a security becoming a threshold security did not have to be closed out in accordance with Regulation SHO's thirteen consecutive settlement day close-out requirement.

Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continued to observe threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, effective on October 15, 2007, we adopted an amendment to Regulation SHO that eliminated the "grandfather" exception to Regulation SHO's close-out requirement.[17]

The options market maker exception excepted any fail to deliver position in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a

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[15] Rule 203(c)(6) of Regulation SHO defines a "threshold security" as any equity security of an issuer that is registered pursuant to Section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to Section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding; and is included on a list disseminated to its members by a self-regulatory organization ("SRO"). See 17 CFR 242.203(c)(6).

[16] See 17 CFR 242.203(b)(3)(iv).

[17] See 2007 Regulation SHO Final Amendments, 72 FR 45544. This amendment also contained a one-time phase-in period that provided that previously-grandfathered fails to deliver in a security that was a threshold security on the effective date of the amendment must be closed out within 35 consecutive settlement days from the effective date of the amendment. The phase-in period ended on December 5, 2007.

threshold security. On September 17, 2008, as part of the September Emergency Order, we adopted and made immediately effective an amendment to Rule 203(b)(3) of Regulation SHO to eliminate the options market maker exception to the rule's close-out requirement.[18] Following the issuance of the September Emergency Order, we adopted amendments making permanent the elimination of the options market maker exception.[19] As we discussed in the 2008 Regulation SHO Final Amendments, we believe it was appropriate to eliminate the options market maker exception in part because substantial levels of fails to deliver continue to persist in threshold securities and it appears that a significant number of these fails to deliver are as a result of the options market maker exception.[20]

In addition to the actions we have taken aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling in threshold securities, we have also taken action targeting potentially abusive "naked" short selling in both threshold and non-threshold securities. For example, in the September Emergency Order we adopted and made immediately effective a "naked" short selling anti-fraud rule, Rule 10b-21, aimed at sellers, including broker-dealers acting for their own accounts, who deceive certain specified persons about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement

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18 See September Emergency Order, supra note 4.

19 See Exchange Act Release No. 58775 (Oct. 14, 2008) (adopting final amendments to Rule 203(b)(3) of Regulation SHO to eliminate the options market maker exception from the rule's close-out requirement) ("2008 Regulation SHO Final Amendments"); see also Exchange Act Release No. 56213 (Aug. 7, 2007), 72 FR 45558 (Aug. 14. 2007) ("2007 Regulation SHO Proposed Amendments); Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006) ("2006 Regulation SHO Proposed Amendments"); Exchange Act Release No. 58107 (July 7, 2008), 73 FR 40201 (July 14, 2008) ("2008 Regulation SHO Re-Opening Release").

20 See 2008 Regulation SHO Final Amendments, supra note 19; see also 2008 Regulation SHO Re-Opening Release, 73 FR 40201.

date.[21] Following the issuance of the September Emergency Order, we adopted final amendments making Rule 10b-21 permanent.[22]

Also, as mentioned above, in the July Emergency Order and the Short Sale Ban Emergency Order, we took emergency action targeting "naked" short selling in the securities of certain financial firms that included non-threshold securities. Specifically, on July 15, 2008, we published the July Emergency Order[23] that temporarily imposed enhanced requirements on short sales in the publicly traded securities of certain substantial financial firms. The July Emergency Order required that, in connection with transactions in the publicly traded securities of the substantial financial firms identified in Appendix A to the Emergency Order ("Appendix A Securities"), no person could effect a short sale in the Appendix A Securities using the means or instrumentalities of interstate commerce unless such person or its agent had borrowed, or arranged to borrow, the security or otherwise had the security available to borrow in its inventory, prior to effecting such short sale. The July Emergency Order also required that the short seller deliver the security on settlement date, prohibiting any fails to deliver in the Appendix A Securities.[24]

We issued the July Emergency Order because we were concerned that false rumors regarding financial institutions of significance in the U.S. may have fueled market volatility in the securities of some of these institutions. As we noted in the July Emergency Order, false rumors can lead to a loss of confidence in our markets. Such loss of confidence can lead to panic

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21 See September Emergency Order, supra note 4.

22 See Exchange Act Release No. 58774 (Oct. 14, 2008) ("Anti-Fraud Rule Adopting Release"); see also Exchange Act Release No. 57511 (March 17, 2008), 73 FR 15376 (March 21, 2008) ("Anti-Fraud Rule Proposing Release").

23 See supra note 1.

24 See id.

selling, which may be further exacerbated by "naked" short selling. As a result, the prices of securities may artificially and unnecessarily decline below the price level that would have resulted from the normal price discovery process. If significant financial institutions are involved, this chain of events can threaten disruption of our markets.[25]

On July 29, 2008, we extended the July Emergency Order after carefully reevaluating the current state of the markets in consultation with officials of the Board of Governors of the Federal Reserve System, the Department of the Treasury, and the Federal Reserve Bank of New York and remaining concerned about the ongoing threat of market disruption and effects on investor confidence.[26] Pursuant to the extension, the July Emergency Order terminated at 11:59 p.m. EDT on August 12, 2008.

Due to our continued concerns regarding recent market conditions and that short selling in the securities of a wider range of financial institutions than those subject to the July Emergency Order may be causing sudden and excessive fluctuations of the prices of such securities that could threaten fair and orderly markets, on September 18, 2008, we issued the Short Sale Ban Emergency Order.[27] The Short Sale Ban Emergency Order temporarily prohibited any person from effecting a short sale in the publicly traded securities of certain financial institutions. On October 2, 2008, we extended the Short Sale Ban Emergency Order due to our continued concerns regarding the ongoing threat of market disruption and investor

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[25] We delayed the effective date of the July Emergency Order to July 21, 2008 to create the opportunity to address, and to allow sufficient time for market participants to make, adjustments to their operations to implement the enhanced requirements. Moreover, in addressing anticipated operational accommodations necessary for implementation of the July Emergency Order, we issued an amendment to the July Emergency Order on July 18, 2008. See Exchange Act Release No. 58190 (July 18, 2008) (excepting from the July Emergency Order bona fide market makers, short sales in Appendix A Securities sold pursuant to Rule 144 of the Securities Act of 1933, and certain short sales by underwriters, or members of a syndicate or group participating in distributions of Appendix A Securities).

[26] See Exchange Act Release No. 58248 (July 29, 2008), 73 FR 45257 (Aug. 4, 2008).

[27] See supra note 2.

confidence in the financial markets.[28] Pursuant to the extension, the Short Sale Ban Emergency Order terminated at 11:59 p.m. EDT on October 8, 2008.

Our concerns are no longer limited to just the financial institutions that were the subject of the July Emergency Order and the Short Sale Ban Emergency Order. Given the importance of confidence in our financial markets as a whole, we have become concerned about sudden and unexplained declines in the prices of equity securities generally. These concerns resulted in our adopting and making immediately effective in the September Emergency Order the enhanced delivery requirements contained in temporary Rule 204T.[29] For the reasons explained in detail herein, today we are adopting the temporary rule as set forth in the September Emergency Order, with modifications to address technical and operational concerns resulting from the requirements of the temporary rule.

III. Concerns about "Naked" Short Selling

We have been concerned about "naked" short selling and, in particular, abusive "naked" short selling, for some time. As discussed above, such concerns were a primary reason for our adoption of Regulation SHO in 2004, the elimination of the "grandfather" and options market maker exceptions to Regulation SHO's close-out requirement, the adoption of a "naked" short selling antifraud rule, and our recent issuance of the July Emergency Order, Short Sale Ban Emergency Order, and the September Emergency Order.

Despite these Commission actions, due to our continuing concerns about the potential impact of "naked" short selling on the weakened financial markets, we believe it is necessary to

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[28] See Exchange Act Release No. 58723 (Oct. 2, 2008) (stating that the Short Sale Ban Emergency Order would terminate the earlier of (i) three business days from the President's signing of the Emergency Economic Stabilization Act of 2008 (H.R. 1424), or (ii) 11:59 p.m. E.D.T. on Friday, October 17, 2008).

[29] See September Emergency Order, supra note 4.

immediately adopt as an interim final temporary rule, temporary rule 204T, with some modifications to address technical and operational concerns resulting from the rule's requirements as set forth in the September Emergency Order. We believe that adoption of temporary rule 204T as an interim final temporary rule is necessary to further address abusive "naked" short selling and, therefore, fails to deliver resulting from such short sales, in all equity securities. As we have stated on several prior occasions, we believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased.[30] In addition, as we have stated on several prior occasions, we are concerned about the negative effect that fails to deliver may have on the markets and shareholders.[31]

For example, large and persistent fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.[32] In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.[33] Moreover, sellers that fail to deliver securities on settlement date may attempt to use this additional freedom to engage in trading activities to improperly depress the price of a security. For example, by not borrowing securities and, therefore, not making delivery within the standard three-day settlement period, the seller does not incur the costs of borrowing.

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30 See, e.g., Anti-Fraud Rule Proposing Release, 73 FR at 15376.

31 See, e.g., 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Anti-Fraud Rule Proposing Release, 73 FR at 15378.

32 See id.

33 See id.

In addition, issuers and investors have repeatedly expressed concerns about fails to deliver in connection with manipulative "naked" short selling. For example, in response to proposed amendments to Regulation SHO in 2006[34] designed to further reduce the number of persistent fails to deliver in certain equity securities by eliminating Regulation SHO's "grandfather" exception, and limiting the duration of the rule's options market maker exception, we received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[35] Commenters continued to express these concerns in response to proposed amendments to eliminate the options market maker exception to the close-out requirement of Regulation SHO in 2007.[36]

To the extent that fails to deliver might be part of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[37] such fails to deliver may undermine the confidence of investors.[38] These investors, in turn, may be reluctant to commit

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34 See 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

35 See, e.g., letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Sept. 11, 2006; letter from Daniel Behrendt, Chief Financial Officer, and Douglas Klint, General Counsel, TASER International, dated Sept. 18, 2006; letter from John Royce, dated April 30, 2007; letter from Michael Read, dated April 29, 2007; letter from Robert DeVivo, dated April 26, 2007; letter from Ahmed Akhtar, dated April 26, 2007.

36 See, e.g., letter from Jack M. Wedam, dated Oct. 16, 2007; letter from Michael J. Ryan, Executive Director and Senior Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated Sept. 13, 2007 ("U.S. Chamber of Commerce"); letter from Robert W. Raybould, CEO Enteleke Capital Corp., dated Sept. 12, 2007 ("Raybould"); letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 11, 2007 ("NCANS").

37 See supra note 9 (discussing a case in which we alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the company's stock, and depressed its price); see also S.E.C. v. Gardiner, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. March 27, 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price); U.S. v. Russo, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b-5).

38 In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters discussing the impact of fails to deliver on investor confidence. See, e.g., letter from NCANS. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 30, 2006 ("NCANS (2006)"); letter from Richard Blumenthal, Attorney General, State of Connecticut, dated Sept. 19, 2006 ("Blumenthal").

capital to an issuer they believe to be subject to such manipulative conduct.[39] In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[40] Unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[41]

IV. Discussion of Temporary Rule 204T

A. Rule 204T's Close-Out Requirement

In these unusual and extraordinary times and in an effort to prevent substantial disruption to the securities markets, we have concluded that it is necessary to immediately adopt as an interim final temporary rule, temporary rule Rule 204T, with some modifications to address technical and operational concerns resulting from the rule's requirements as set forth in the

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39 In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters expressing concern about the impact of potential "naked" short selling on capital formation, claiming that "naked" short selling causes a drop in an issuer's stock price and may limit the issuer's ability to access the capital markets. See, e.g., letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007 ("Medis"); letter from NCANS. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Congressman Tom Feeney - Florida, U.S. House of Representatives, dated Sept. 25, 2006 ("Feeney"); see also letter from Zix Corporation, dated Sept. 19, 2006 ("Zix") (stating that "[m]any investors attribute the Company's frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company "do something" about the perceived manipulative short selling. This perception that manipulative short selling of the Company's securities is continually occurring has undermined the confidence of many of the Company's investors in the integrity of the market for the Company's securities.").

40 Due in part to such concerns, some issuers have taken actions to attempt to make transfer of their securities "custody only," (i.e., certificating the securities and prohibiting ownership by a securities intermediary) thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company ("DTC") or broker-dealers. See Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, at 62975 (Nov. 6, 2003). Some issuers have attempted to withdraw their issued securities on deposit at DTC in order to make the securities ineligible for book-entry transfer at a securities depository. See id. Withdrawing securities from DTC or requiring custody-only transfers would undermine the goal of a national clearance and settlement system designed to reduce the physical movement of certificates in the trading markets. See id. We note, however, that in 2003 the Commission approved a DTC rule change clarifying that its rules provide that only its participants may withdraw securities from their accounts at DTC, and establishing a procedure to process issuer withdrawal requests. See Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037 (June 11, 2003).

41 See 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Amendments, 72 FR at 45544; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Anti-Fraud Rule Proposing Release, 73 FR at 15378 (providing additional discussion of the impact of fails to deliver on the market); see also Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) (discussing the impact of "naked" short selling on the market).

September Emergency Order. We believe that adoption of the temporary rule will substantially restrict the practice of potentially abusive "naked" short selling in all equity securities by strengthening the delivery requirements for such securities.[42]

Specifically, temporary Rule 204T(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours[43] on the settlement day[44] following the settlement date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.[45]

Temporary Rule 204T(a)'s close-out requirement requires a participant of a registered clearing agency that has a fail to deliver position at a registered clearing agency on the settlement date for a transaction to immediately borrow or purchase securities to close out the amount of the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date (the "Close-Out Date"). This close-out requirement requires that the participant take affirmative action to purchase or borrow securities. Thus, a participant may not offset the amount of its settlement date fail to deliver position with shares that the

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42 As noted above, in a "naked" short sale, the short seller does not borrow or arrange to borrow securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver securities to the buyer when delivery is due. See supra note 7 and supporting text.

43 "Regular trading hours" has the same meaning as in Rule 600(b)(64) of Regulation NMS. Rule 600(b)(64) provides that "Regular trading hours means the time between 9:30 a.m. and 4:00 p.m. Eastern Time, or such other time as is set forth in the procedures established pursuant to § 242.605(a)(2)."

44 The term "settlement day" is defined in Rule 203(c)(5) of Regulation SHO as: ". . . any business day on which deliveries of securities and payments of money may be made through the facilities of a registered clearing agency." 17 CFR 242.203(c)(5).

45 See temporary Rule 204T(a).

participant receives or will receive on the Close-Out Date.[46] To meet its close-out obligation a participant also must be able to demonstrate on its books and records that on the Close-Out Date it purchased or borrowed shares in the full quantity of its settlement date fail to deliver position and, therefore, that the participant has a net flat or net long position on its books and records in that equity security on the Close-Out Date.

The temporary rule defines a "settlement date" as "the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security."[47] This definition is consistent with Rule 15c6-1 that prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.[48]

Because most transactions settle by T+3 and because delivery on all sales should be made by settlement date, participants should consider having in place policies and procedures to help ensure that delivery is being made by settlement date. We intend to examine participants' policies and procedures to determine whether such policies and procedures monitor for delivery by settlement date.[49]

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46 In determining its close-out obligation, a participant may rely on its net delivery obligation as reflected in its notification from NSCC regarding its securities delivery and payment obligations, provided such notification is received prior to the beginning of regular trading hours on the Close-Out Date.

47 See temporary Rule 204T(f)(1).

48 See 17 CFR 240.15c6-1.

49 Of course, broker-dealers must comply with any applicable SRO policies and procedures requirements. For example, NASD Rule 3010 contains, among other things, written procedures requirements for member firms.

Similar to the existing close-out requirement of Rule 203(b)(3) of Regulation SHO, the temporary rule is based on a participant's fail to deliver position at a registered clearing agency. As noted above, the NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter markets. NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of their securities delivery and payment obligations daily. Because the temporary rule is based on a participant's fail to deliver position at a registered clearing agency, the temporary rule is consistent with current settlement practices and procedures and with the Regulation SHO framework regarding delivery of securities.[50]

In addition, similar to Rule 203(b)(3)(vi) of Regulation SHO, the temporary rule provides that a participant may reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer from which the participant receives trades for clearance or settlement.[51] Specifically, temporary Rule 204T(d) provides that if a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or from which it receives trades for settlement, based on such broker's or dealer's short position, the provisions of Rule 204T(a) and (b) relating to such fail to

[50] See 17 CFR 242.203(b)(3) (Regulation SHO's close-out requirement). Consistent with current industry practice under Regulation SHO, with respect to a net syndicate short position created in connection with a distribution of a security that is part of a fail to deliver position at a registered clearing agency, the requirements of temporary Rule 204T shall not apply provided action is taken to close out the net syndicate short position by no later than the beginning of regular trading hours on the thirtieth day after commencement of sales in the distribution.. See e.g., Exchange Act Release No. 58190 (July 18, 2008) (amending the July Emergency Order to provide an exception from its requirements for fails to deliver in connection with syndicate offerings).

[51] See 17 CFR 242.203(b)(3)(vi). Rule 203(b)(3)(vi) provides that "[i]f a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this paragraph (b)(3) relating to such fail to deliver position shall apply to the portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant."

deliver position shall apply to such registered broker or dealer that was allocated the fail to deliver position, and not to the participant.[52]

Thus, participants that are able to identify the accounts of broker-dealers for which they clear or from which they receive trades for settlement, could allocate the responsibility to close out the fail to deliver position to the particular broker-dealer account(s) whose trading activities have caused the fail to deliver position provided the allocation is reasonable (e.g., the allocation must be timely). Absent such identification, however, the participant would remain subject to the close-out requirement.

Unlike Rule 203(b)(3)(vi) of Regulation SHO, temporary Rule 204T(d) imposes an additional notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements. Specifically, temporary Rule 204T(d) provides that a broker or dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of temporary Rule 204T(a) must immediately notify the participant that it has become subject to the borrowing requirements of temporary Rule 204T(b).[53] We are adopting this notification requirement so that participants will know when a broker-dealer for which they clear and settle trades has become subject to the temporary rule's borrowing requirements.

The temporary rule also differs from the current close-out requirement of Regulation SHO in that it applies to fails to deliver in all equity securities rather than only to those securities with a large and persistent level of fails to deliver, i.e., threshold securities. A primary purpose of the temporary rule is to prevent the use of "naked" short selling as part of a manipulative

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[52] See temporary Rule 204T(d).

[53] See id.

scheme. To achieve this purpose, the rule must apply to all equity securities, regardless of the level or persistence of any fails to deliver in such securities. In addition, as discussed above, we believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. We believe this should be the case for sales in all equity securities and are adopting this temporary rule to further that goal.

Regulation SHO, as adopted in 2004, was a first step in trying to reduce persistent fails to deliver and address abusive "naked" short selling. In Regulation SHO, we took a targeted approach, imposing additional delivery requirements on securities with a substantial and persistent amount of fails to deliver. As we stated in the 2004 Regulation SHO Adopting Release, we took this targeted approach at that time in an effort not to burden the vast majority of securities where there are not similar concerns regarding settlement.[54] In addition, Regulation SHO's close-out requirement was adopted to address potential abuses that may occur with large, extended fails to deliver.[55] We also noted in the 2004 Regulation SHO Adopting Release, however, that we would pay close attention to the operation and efficacy of the provisions we were adopting at that time and would consider whether any further action was warranted.[56]

Because of continued concerns about the potentially negative market impact of fails to deliver, and the fact that through our monitoring of the efficacy of Regulation SHO's close-out requirement we continued to observe threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, we eliminated the

[54] See 2004 Regulation SHO Adopting Release, 69 FR at 48016.

[55] See id. at 48017.

[56] See id. at 48018.

"grandfather" and options market maker exceptions to Regulation SHO's close-out requirements.[57]

However, we are concerned that Regulation SHO's current provisions have not gone far enough in reducing fails to deliver and addressing potentially abusive "naked" short selling.[58] More is needed to reduce fails to deliver and to address potentially abusive "naked" short selling, especially in light of the current instability and lack of investor confidence in the financial markets.[59] In addition, because Regulation SHO's close-out requirement applies only to threshold securities, fails to deliver in non-threshold securities never have to be closed out.[60] We believe that adoption of temporary rule 204T as an interim final temporary rule is necessary to curtail fails to deliver in both threshold and non-threshold securities to further address abusive "naked" short selling in such securities.

As discussed above, due to our concerns about potentially abusive "naked" short selling in certain non-threshold securities, we recently issued the July Emergency Order to temporarily impose enhanced requirements on short sales in the Appendix A Securities. Following our

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[57] On June 13, 2007, we adopted amendments to eliminate the "grandfather" exception to Regulation SHO's close-out requirement. On September 17, 2008, in the September Emergency Order, we adopted amendments to eliminate the options market maker exception, which amendments were subsequently made permanent. See supra notes 17, 18 and 19.

[58] See, e.g., 2007 Regulation SHO Final Amendments, 72 FR 45544 (eliminating the "grandfather" exception to Regulation SHO's close-out requirement due to our observing continued fails to deliver in threshold securities); 2008 Regulation SHO Final Amendments, supra note 19 (eliminating the options market maker exception to Regulation SHO's close-out requirement due to substantial levels of fails to deliver continuing to persist in optionable threshold securities).

[59] See, e.g., letter from Leland Chan, General Counsel, California Bankers Association, dated Aug. 21, 2008; letter from Eric C. Jensen, Esq., Cooley Godward Kronish L.P., dated Aug. 21, 2008; letter from Steven B. Boehm and Cynthia M. Krus, Sutherland Asbill Brennan LLP, dated July 31, 2008; letter from James J. Angel, Professor of Finance, Georgetown University, McDonough School of Business, dated Aug. 20, 2008; letter from Tuan Nguyen, dated Aug. 8, 2008.

[60] OEA estimates that fails to deliver in non-threshold securities averaged approximately 624 million shares or \$4.6 billion in value per day from January to July 2008. These fails account for approximately 54.5% (56.6%) of all fail to deliver shares (by dollar value).

issuance of the July Emergency Order, we issued the Short Sale Ban Emergency Order in which we took the additional step of prohibiting short selling in the securities of a wider range of financial institutions than those subject to the July Emergency Order. In addition, we issued the September Emergency Order which, in part, imposed enhanced delivery requirements for transactions in all equity securities and made effective immediately a "naked" short selling antifraud rule. We took these emergency actions because we were concerned about panic selling in securities due to a loss of confidence that could be further exacerbated by "naked" short selling.

Following the issuance of the July Emergency Order, members of the public have repeatedly expressed their concerns about a loss of confidence in the financial markets.[61] In addition, since the termination of the July Emergency Order and the issuance of the Short Sale Ban Emergency Order and the September Emergency Order, we have continued our evaluation of the markets and our discussions with the Federal Reserve, Treasury, and the Federal Reserve Bank of New York regarding the state of the financial markets. In light of these processes, we have determined that we must take action to adopt as an interim final temporary rule, temporary Rule 204T, to substantially restrict "naked" short selling in all equity securities. As with the July Emergency Order, the Short Sale Ban Emergency Order, and the September Emergency Order, we are adopting this temporary rule as a preventative step to help restore market confidence.

In addition to applying the temporary rule to fails to deliver in all equity securities, rather than just threshold securities, the temporary rule also differs from the close-out requirement of

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61 See, e.g., letter from Tom Donohue, President, U.S. Chamber of Commerce, dated July 15, 2008; letter from Ron Heller, dated July 21, 2008; letter from Ronald L. Rourk, dated July 21, 2008; letter from Wayne Jett, Managing Principal and Chief Economist at Classical Capital, LLC, dated July 24, 2008; letter from Edward Herlihy and Theodore Levine, Wachtell, Lipton, Rosen and Katz, LLP, dated Sept. 16, 2008; letter from Sen. Hillary Rodham Clinton, dated Sept. 17, 2008; letter from Representative D. Burton, dated Sept. 18, 2008; letter from Elliott Bossen, Chief Investment Officer at Silverback Asset Management, dated Sept. 24, 2008.

Rule 203(b)(3) of Regulation SHO in that it shortens the close-out period for such fails to deliver.[62] For the reasons discussed below, rather than requiring close out of a fail to deliver position within thirteen consecutive settlement days (or 10 days after settlement date), temporary Rule 204T requires a participant to immediately purchase or borrow shares to close out a fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the day on which the fail to deliver position occurs.

As noted above, trades in most securities generally settle within a three-day settlement cycle, known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade are expected to deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third business day. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options typically settle on the next business day following the trade (or T+1).[63] We believe that delivery on all sales should be made by settlement date and, therefore, in temporary Rule 204T we are requiring that fails to deliver in all equity securities be closed out by no later than the beginning of regular trading hours on the Close-Out Date.

In the 2004 Regulation SHO Adopting Release we stated we were adopting a thirteen consecutive settlement day close-out requirement in part because the close-out requirement applied to fails to deliver resulting from long and short sales in threshold securities, and

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[62] Rule 203(b)(3) of Regulation SHO provides: "If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity." See 17 CFR 242.203(b)(3).

[63] See supra note 8.

extending the time period to ten days after settlement date for a transaction would make the close-out requirement consistent with Rule 15c3-3(m).[64] In addition, we noted in that release that ten days after settlement was also the timeframe used at that time in NASD Rule 11830.[65] We also acknowledged that a shorter timeframe, such as two days after settlement, may capture many instances of ordinary course settlement delays.[66]

In addition, we have stated previously that the vast majority of fails to deliver are closed out within five days after T+3.[67] In addition, a recent analysis by our Office of Economic Analysis found that more than half of all fails to deliver and more than 70% of all fail to deliver positions are closed out within two settlement days after T+3.[68] Although this information shows that delivery is being made, it demonstrates that often delivery is not being made until several days following the standard three-day settlement cycle. In addition, the current close-out requirement for threshold securities under Regulation SHO and the lack of any close-out requirement for non-threshold securities under Regulation SHO enables fails to deliver to persist for many days beyond settlement date. We believe that allowing fails to deliver to extend out beyond settlement date for a transaction is too long.

We have continuously monitored the extent of fails to deliver and abusive "naked" short selling in the markets. We believe that allowing fails to deliver in all equity securities to persist

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64 See 17 CFR 240.15c3-3(m).

65 See 2004 Regulation SHO Adopting Release, 69 FR at 48017, n.93.

66 See id.

67 See, e.g., 2007 Regulation SHO Final Amendments, 72 FR at 45544, n.5.

68 OEA's analysis examined the period from January to July 2008 and used the age of the fail to deliver position as reported by the NSCC. The NSCC data included only securities with at least 10,000 shares in fails to deliver. We note that these numbers included securities that were not subject to the close-out requirement in Rule 203(b)(3) of Regulation SHO, which applies only to "threshold securities" as defined in Rule 203(c)(6) of Regulation SHO.

for thirteen consecutive settlement days (10 days after settlement date) if such securities are threshold securities, or indefinitely if such securities are not threshold securities, is too long. As discussed above, fails to deliver may be indicative of a scheme to manipulate the price of a security. In addition, we are concerned about the negative effect that fails to deliver and potentially abusive "naked" short selling may have on the market and the broader economy, including on investor confidence. Temporary Rule 204T addresses these concerns by requiring a participant to immediately close out a fail to deliver position by purchasing or borrowing securities by no later than the beginning of regular trading hours on the Close-Out Date.

We believe we should act to require earlier close out so that more sales settle by settlement date. Indeed, we believe that delivery on all sales should be made by settlement date. As we discuss above, and as we have stated on several prior occasions, we believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased.[69] Although the temporary rule's close-out requirement may capture some instances of ordinary course settlement delays, we believe that the temporary rule's close-out requirement is necessary to help ensure that fails to deliver in all equity securities settle by settlement date. In addition, as discussed above, due to our belief that delivery should be made by settlement date, participants should consider having policies and procedures in place to monitor for the delivery of securities by settlement date.

We understand, however, that fails to deliver may occur from long sales within the first two settlement days after settlement date for legitimate reasons. For example, human or mechanical errors or processing delays can result from transferring securities in custodial or

[69] See supra note 30.

other form rather than book-entry form, thereby causing a fail to deliver on a long sale within the normal three-day settlement period.

Thus, temporary Rule 204T(a)(1) includes an exception from the temporary rule's close-out requirement for fail to deliver positions resulting from long sales of all equity securities. Specifically, temporary Rule 204T(a)(1) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security and the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.[70]

B. Borrowing Requirements

If a participant does not purchase or borrow shares, as applicable, to close out a fail to deliver position in accordance with temporary Rule 204T, the participant violates the close-out requirement of the temporary rule. In addition, the temporary rule imposes on the participant for its own trades and on all broker-dealers from which that participant receives trades for clearance and settlement (including introducing and executing brokers), a requirement to borrow or arrange to borrow securities prior to accepting or effecting further short sales in that security.

Specifically, temporary Rule 204T(b) provides that the participant and any broker or dealer from which it receives trades for clearance and settlement, including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation

70 See temporary Rule 204T(a)(1). We note that if a person that has loaned a security to another person sells the security and a bona fide recall of the security is initiated within two business days after trade date, the person that has loaned the security will be "deemed to own" the security for purposes of Rule 200(g)(1) of Regulation SHO, and such sale will not be treated as a short sale for purposes of temporary Rule 204T. In addition, a broker-dealer may mark such orders as "long" sales provided such marking is also in compliance with Rule 200(c) of Regulation SHO. Thus, the close-out requirement of temporary Rule 204T(a)(1) applies to sales of such securities.

SHO,[71] may not accept a short sale order in an equity security from another person, or effect a short sale order in such equity security for its own account, to the extent that the broker or dealer submits its short sales to that participant for clearance and settlement, without first borrowing the security, or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.[72]

The borrow requirements of temporary Rule 204T(b) are consistent with the requirements of Rule 203(b)(3)(iv) of Regulation SHO for a participant that has not closed out a fail to deliver position in a threshold security that has persisted for thirteen consecutive settlement days.[73] Similar to Regulation SHO, the temporary rule is aimed at addressing potentially abusive "naked" short selling. To that end, we believe it is appropriate to include in the temporary rule borrow requirements for broker-dealers, including participants, that sell short a security that has a fail to deliver position that has not been closed out in accordance with the requirements of the temporary rule. We believe that the borrow requirements of temporary Rule 204T(b) will further our goal of limiting fails to deliver and addressing abusive "naked" short selling by promoting the prompt and accurate clearance and settlement of securities transactions. By requiring that participants and broker-dealers from which they receive trades for clearance and settlement

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71 See 17 CFR 242.203(b)(2)(iii) (providing an exception from Regulation SHO's "locate" requirement for short sales effected by a market maker in connection with bona fide market making activities in the securities for which the exception is claimed).

72 See temporary Rule 204T(b).

73 See 17 CFR 242.203(b)(3)(iv). Rule 203(b)(3)(iv) of Regulation SHO provides that "[i]f a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of this section, many not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity."

borrow or arrange to borrow securities prior to accepting or effecting short sales in the security that has a fail to deliver position that has not been closed out, the temporary rule will help to ensure that shares will be available for delivery on the short sale by settlement date and, thereby, help to avoid additional fails to deliver occurring in the security.

Unlike the borrow requirements of Rule 203(b)(3)(iv) of Regulation SHO, however, the borrow requirements of the temporary rule specify that participants must notify all broker-dealers from which they receive trades for clearance and settlement that a fail to deliver position has not been closed out in accordance with temporary Rule 204T. Specifically, temporary Rule 204T(c) provides that the participant must notify any broker or dealer from which it receives trades for clearance and settlement, including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,[74] (a) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of temporary Rule 204T, and (b) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.[75]

We are including this notification requirement in temporary Rule 204T(c) so that all broker-dealers that submit trades for clearance and settlement to a participant that has a fail to deliver position in a security that has not been closed out in accordance with temporary Rule 204T will be on notice that short sales in that security to be cleared or settled through that participant will be subject to the borrow requirements of temporary Rule 204T(b) until the fail to deliver position has been closed out.

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[74] See 17 CFR 203(b)(2)(iii) (providing for an exception from the "locate" requirement for market makers engaged in bona fide market making in that security at the time of the short sale).

[75] See temporary Rule 204T(c).

The temporary rule, however, includes an exception from the borrowing requirements for any broker-dealer that can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. Specifically, temporary Rule 204T(b)(1) provides that a broker or dealer shall not be subject to the requirements of temporary Rule 204T(b) if the broker or dealer timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with the requirements of temporary Rule 204T(e).[76] We have included this exception because we do not believe that a broker-dealer should be subject to the borrowing requirements of the temporary rule if the broker-dealer can demonstrate that it did not incur a fail to deliver position in the security on settlement date.

In addition, as noted above, the temporary rule provides that a participant may reasonably allocate (e.g., the allocation must be timely) its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears or from which the participant receives trades for settlement. Thus, to the extent that the participant can identify the broker-dealer(s) that have contributed to the fail to deliver position, and the participant has reasonably allocated the close-out obligation to the broker-dealer(s), the requirement to borrow or arrange to borrow prior to effecting further short sales in that security will apply to only those particular broker-dealer(s).

C. Pre-Fail Credit

To avoid the borrow or arrangement to borrow requirement of temporary Rule 204T(a), a participant could close-out the fail by borrowing and delivering securities sufficient to close-out

[76] See temporary Rule 204T(b)(1). Temporary Rule 204T(e) is discussed in detail below in Section IV.C.

the fail to deliver position prior to the beginning of regular trading hours on the Close-Out Date. If, however, the participant does not succeed in eliminating the fail to deliver position the participant can only close out that position by immediately borrowing or purchasing securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the Close-Out Date in accordance with temporary Rule 204T.

To encourage close outs of fail to deliver positions prior to the Close-Out Date, similar to the September Emergency Order,[77] temporary Rule 204T(e) provides that a broker-dealer can satisfy the temporary rule's close-out requirement by purchasing securities in accordance with the conditions of that provision (i.e., broker-dealers will receive "pre-fail credit" for the purchase). Specifically, temporary Rule 204T(e) provides that even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with temporary Rule 204T(a), or has not allocated a fail to deliver position to a broker or dealer in accordance with temporary Rule 204T(d), a broker or dealer shall not be subject to the requirements of paragraphs (a) or (b) of the temporary rule if the broker or dealer purchases securities prior to the beginning of regular trading hours on the Close-Out Date for a long or short sale to close out an open short position, and if:

(1) The purchase is bona fide;

(2) The purchase is executed on, or after, trade date but by no later than the end of regular trading hours on settlement date for the transaction;

(3) The purchase is of a quantity of securities sufficient to cover the entire amount of the open short position; and

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77 See Exchange Act Release No. 58711 (Oct. 1, 2008) (stating that in connection with extending the September Emergency Order, the Commission incorporates and adopts the Division of Trading and Markets: Guidance Regarding the Commission's Emergency Order Concerning Rules to Protect Investors Against "Naked" Short Selling Abuses and the Division of Trading and Markets Guidance Regarding Sale of Loaned but Recalled Securities).

(4) The broker or dealer can demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is seeking to demonstrate that it has purchased shares to close out its open short position.

To receive pre-fail credit under temporary Rule 204T(e), the purchase must be "bona fide." Thus, where a broker-dealer enters into an arrangement with another person to purchase securities, and the broker-dealer knows or has reason to know that the other person will not deliver securities in settlement of the transaction, the purchase will not be considered to be "bona fide."[78] In addition, the purchase must be of a quantity of securities sufficient to cover the entire amount of the open short position.[79]

Temporary Rule 204T(e) also requires that to receive pre-fail credit, the purchase must be executed on, or after, trade date but by no later than the end of regular trading hours on the settlement date of the transaction that resulted in the fail to deliver position at a registered clearing agency.[80] The purpose of this provision is to encourage broker-dealers to close out fail to deliver positions prior to the beginning of regular trading hours on the Close-Out Date.

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78 See 17 CFR 203(b)(3)(vii) (discussing bona fide purchases for purposes of Regulation SHO). It is possible under Regulation SHO that a close out by a participant of a registered clearing agency may result in a fail to deliver position at another participant if the counterparty from which the participant purchases securities fails to deliver. However, Regulation SHO prohibits a participant of a registered clearing agency, or a broker-dealer for which it clears transactions, from engaging in "sham close outs" by entering into an arrangement with a counterparty to purchase securities for purposes of closing out a fail to deliver position and the purchaser knows or has reason to know that the counterparty will not deliver the securities, and which thus creates another fail to deliver position. See id. at (b)(3)(vii); 2004 Regulation SHO Adopting Release, 69 FR at 48018 n.96. In addition, we note that borrowing securities, or otherwise entering into an arrangement with another person to create the appearance of a purchase would not satisfy the close-out requirement of Regulation SHO. For example, the purchase of paired positions of stock and options that are designed to create the appearance of a bona fide purchase of securities but that are nothing more than a temporary stock lending arrangement would not satisfy Regulation SHO's close-out requirement.

79 See temporary Rule 204T(e)(3).

80 See temporary Rule 204T(e)(2).

In addition, to help ensure that broker-dealers purchase sufficient shares to close out their fail to deliver positions, temporary Rule 204T(e) requires that the broker-dealer claiming pre-fail credit be net long or net flat on the settlement day on which the broker-dealer is claiming pre-fail credit.[81] In addition, the temporary Rule 204T(e) requires that the broker-dealer be able to demonstrate that it has complied with this requirement.[82] This requirement will enable the Commission and SROs to monitor more effectively whether or not a broker-dealer has complied with the requirements of temporary Rule 204T(e).

D. Market Makers

To allow market makers to facilitate customer orders in a fast moving market, similar to the September Emergency Order,[83] temporary rule includes a limited exception from the rule's close-out and borrowing requirements for fails to deliver attributable to bona fide market making activities by registered market makers, options market makers, or other market makers obligated to quote in the over-the-counter market. Specifically, temporary Rule 204T(a)(3) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security that is attributable to bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market (individually a "Market Maker," collectively "Market Makers"), the participant shall by no later than the beginning of regular trading hours on the third consecutive

81 See temporary Rule 204T(e)(4).

82 See id.

83 See supra note 77.

settlement day following the settlement date, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.[84]

In addition, similar to the September Emergency Order,[85] the temporary rule excepts Market Makers from the borrowing requirements of temporary Rule 204T(b) if the Market Maker can demonstrate that it does not have an open fail to deliver position at the time of any additional short sales. The borrowing requirements of the temporary rule apply to all broker-dealers from which a participant of a registered clearing agency receives trades for clearance and settlement. To allow Market Makers to facilitate customer orders, we do not believe that a Market Maker should be subject to the temporary rule's borrowing requirements if the Market Maker does not have an open fail to deliver at the time of any additional short sales.

E. Sales Pursuant to Rule 144

The temporary rule includes an exception for sales of all equity securities pursuant to Rule 144 under the Securities Act of 1933 ("Securities Act").[86] Specifically, temporary Rule 204T(a)(2) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in an equity security sold pursuant to Rule 144 for thirty-five consecutive settlement days after the settlement date for a sale in that equity security, the participant shall, by no later than the beginning of regular trading hours on the thirty-sixth

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84 See temporary Rule 204T(a)(3). Unlike the September Emergency Order, however, the temporary rule does not require a Market Maker to which a fail to deliver position at a registered clearing agency is attributable to attest in writing to the market on which it is registered that the fail to deliver position at issue was established solely for the purpose of meeting its bona fide market making obligations and the steps the Market Maker has taken in an effort to deliver securities to its registered clearing agency. We believe the costs of such a requirement would outweigh the benefits. We note, however, that as with any exception, a broker-dealer would have to evidence eligibility for, and compliance with, the requirements of the exception.

85 See supra note 77.

86 See 17 CFR 230.144.

consecutive settlement day following the settlement date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.[87]

Regulation SHO provides an exception from the "locate" requirement of Rule 203(b)(1) for situations where a broker-dealer effects a short sale on behalf of a customer that is deemed to own the security pursuant to Rule 200 of Regulation SHO, although, through no fault of the customer or broker-dealer, it is not reasonably expected that the security will be in the physical possession or control of the broker-dealer by settlement date and, therefore, is a "short" sale under the marking requirements of Rule 200(g).[88] Rule 203(b)(2)(ii) of Regulation SHO provides that in such circumstances, delivery must be made on the sale as soon as all restrictions on delivery have been removed, and in any event no later than 35 days after trade date, at which time the broker-dealer that sold on behalf of the person must either borrow securities or close out the open position by purchasing securities of like kind and quantity.[89] In addition, recently we adopted amendments to the close-out requirement of Regulation SHO to allow fails to deliver resulting from sales of threshold securities pursuant to Rule 144 to be closed out within 35 rather than13 consecutive settlement days.[90]

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87 See temporary Rule 204T(a)(2).

88 Pursuant to Rule 200(g)(2) of Regulation SHO, as adopted in August 2004, generally these sales were marked "short exempt." See 2004 Regulation SHO Adopting Release, 69 FR at 48030-48031; but cf. Exchange Act Release No. 55970 (June 28, 2007), 72 FR 36348 (July 3, 2007) (removing the "short exempt" marking requirement).

89 See 17 CFR 242.203(b)(2)(ii). In the 2004 Regulation SHO Adopting Release, the Commission stated that it believed that 35 calendar days is a reasonable outer limit to allow for restrictions on a security to be removed if ownership is certain. In addition, the Commission noted that Section 220.8(b)(2) of Regulation T of the Federal Reserve Board allows 35 calendar days to pay for securities delivered against payment if the delivery delay is due to the mechanics of the transactions. See 2004 Regulation SHO Adopting Release, 69 FR at 48015, n.72.

90 See 2007 Regulation SHO Final Amendments, 72 FR at 45550-45551.

Securities sold pursuant to Rule 144 under the Securities Act are formerly restricted securities that a seller is "deemed to own," as defined by Rule 200(a) of Regulation SHO.[91] The securities, however, may not be capable of being delivered on the settlement date due to processing delays related to removal of the restricted legend and, therefore, sales of these securities frequently result in fails to deliver. Consistent with our statements in connection with our recent amendments to Regulation SHO in connection with closing out fails to deliver in threshold securities sold pursuant to Rule 144, we believe that a close-out requirement of 35 consecutive settlement days from settlement date for fails to deliver resulting from sales of all equity securities sold pursuant to Rule 144, will permit the orderly settlement of such sales without the risk of causing market disruption due to unnecessary purchasing activity (particularly if the purchases are for sizable quantities of stock). Because the security being sold will be received as soon as all processing delays have been removed, this additional time will allow participants to close out fails to deliver resulting from the sale of the security with the security sold, rather than having to close out such fail to deliver position by purchasing securities in the market.[92]

If, however, a fail to deliver position resulting from the sale of an equity security pursuant to Rule 144 is not closed out in accordance with temporary Rule 204T(a)(2), the borrowing requirements of temporary Rule 204T(b) will apply. Thus, if a participant does not

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91 See 17 CFR 242.200(a).

92 We understand that sellers that own restricted equity securities that wish to sell pursuant to an effective resale registration statement under Rule 415 under the Securities Act experience similar types of potential settlement delays as sales of securities pursuant to Rule 144 under the Securities Act. Thus, fails to deliver in such securities may be closed out in accordance with temporary Rule 204T(a)(2) if the fails to deliver resulted from sales of securities that were outstanding at the time they were sold and the sale occurred after a registration has become effective. In addition, we understand that sales pursuant to broker-assisted cashless exercises of compensatory options to purchase a company's stock, may result in potential settlement delays and, therefore, fails to deliver. Such fails to deliver may be closed out in accordance with temporary Rule 204T(a)(2).

close out a fail to deliver position at a registered clearing agency in accordance with temporary Rule 204T(a)(2), the temporary rule prohibits the participant, and any broker-dealer from which it receives trades for clearance and settlement, including market makers, from accepting any short sale orders or effecting further short sales in the particular security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.[93]

V. Other Matters

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.[94] This requirement does not apply, however, if the agency "for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest."[95] Further, the Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[96] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[97]

For the reasons discussed throughout this release, we believe that we have good cause to act immediately to adopt this rule on an interim final temporary basis. The September Emergency Order, in which we adopted and made immediately effective temporary Rule 204T expires at 11:59 p.m. EDT on October 17, 2008. As discussed throughout this release, we have

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93 See temporary Rule 204T(b).

94 See 5 U.S.C. §553(b).

95 Id.

96 See 5 U.S.C. §553(d).

97 Id.

determined it is necessary to act immediately and adopt this rule on an interim final temporary basis so that temporary rule 204T remains in effect in the form set forth herein following the expiration of the September Emergency Order.

This temporary rule takes effect on October 17, 2008. For the reasons discussed above, we have acted on an interim final temporary basis. We emphasize that we are requesting comments on the temporary rule and will carefully consider the comments we receive and respond to them in a subsequent release. Moreover, this is a temporary rule, and will expire on July 31, 2009. Setting a termination date for the rule will necessitate further Commission action no later than the end of that period if the Commission intends to continue the same, or similar, requirements contained in the temporary rule.

The sunset provision will enable the Commission to assess the operation of the temporary rule and intervening developments, including a restoration of stability to the financial markets, as well as public comments, and consider whether to continue the rule with or without modification or not at all.

We find that there is good cause to have the temporary rule take effect on October 17, 2008 and that notice and public procedure in advance of effectiveness of the rule are impracticable, unnecessary, and contrary to the public interest.[98]

VI. Request for Comment

We are requesting comments from all members of the public. We will carefully consider the comments that we receive and intend to respond to them in a subsequent release. We seek

98 This finding also satisfies the requirements of 5 U.S.C. §808(2), allowing the rules to become immediately effective notwithstanding the requirements of 5 U.S.C. §801 (if a Federal agency finds that notice and public comment are "impractical, unnecessary, or contrary to the public interest," a rule "shall take effect at such time as the Federal agency promulgating the rule determines.").

comment generally on all aspects of the temporary rule. In addition, we seek comment on the following:

- The temporary rule requires participants to immediately close out a fail to deliver position by no later than the beginning of regular trading hours on the Close-Out Date. Should we narrow the close-out requirement further? Should we allow a longer or shorter period of time within which to close out a fail to deliver position? What would be the justifications for allowing a shorter or longer close-out period?
- Are there any operational or compliance issues related to complying with the requirement in temporary Rule 204T(a) to immediately purchase or borrow securities "by no later than the beginning of regular trading hours"? Should we allow a participant to take steps to purchase or borrow securities after the beginning of regular trading hours on the Close-Out Date to satisfy temporary Rule 204T(a)? If so, how much time after the beginning of regular trading hours should we provide? For example, should we allow trading during an opening auction that commences after the beginning of regular trading hours or should we provide until noon? Alternatively, should we allow participants to purchase or borrow securities at any time on the Close-Out Date to satisfy the temporary rule's close-out requirement? What would be the costs and benefits of allowing additional time beyond the beginning of regular trading hours on the Close-Out Date for the participant to purchase or borrow securities to close out a fail to deliver position?
- Temporary Rule 204T(f)(1) defines "settlement date" as "the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security." Is this an appropriate definition of "settlement date"?

- o Due to our expectation that delivery of securities on all sales should be made by settlement date, we state in the release that participants should consider having in place policies and procedures to monitor for the delivery of securities by settlement date. Should we adopt a rule requiring that participants have in place such policies and procedures?
- o Should a de minimus amount of fails to deliver be excepted from the close-out requirements of the temporary rule? If so, what should be the de minimus amount?
- o Should the temporary rule be expanded to apply to debt as well as equity securities? Please explain.
- o The temporary rule requires that a participant purchase securities by no later than the beginning of regular trading hours on the third settlement day after the settlement date for a fail to deliver position resulting from a long sale transaction. What are the costs associated with purchasing versus borrowing securities to close out a fail to deliver position? Should we permit participants to close out a fail to deliver position for long sale transactions by borrowing as well as purchasing securities? Please explain.
- o The temporary rule allows a participant to close out a fail to deliver position attributable to bona fide market making activity by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market by purchasing securities of like kind and quantity by no later than the beginning of regular trading hours on the third settlement day after the settlement date. Should this close-out period be a shorter or longer time-frame? Please explain. What would be the costs and benefits of a longer or shorter close-out period for such fails to deliver?

- The temporary rule does not include a complete exception from its close-out requirement for options market makers with fails to deliver resulting from short sales effected to establish or maintain a hedge on options positions. We seek comment regarding the impact of the temporary rule on options market makers that are subject to the close-out requirement of the temporary rule. For example, we seek comment regarding the impact of the temporary rule, if any, on liquidity, spread widths, and quote depth in the securities that are subject to the temporary rule.
- The temporary rule allows a participant to close out a fail to deliver position resulting from a sale of an equity security pursuant to Rule 144 of the Securities Act by no later than the beginning of regular trading hours on the thirty-sixth consecutive settlement day after the settlement date. Are there other types of sales that encounter settlement delays due to processing requirements similar to sales of Rule 144 securities that should have an exception from the close-out requirements of temporary Rule 204T(a)? Please explain.
- What impact will the temporary rule have on borrowing costs? Please explain. What impact will the temporary rule have on legitimate short selling and market efficiency?
- An arrangement to borrow means a bona fide agreement to borrow the security such that the security being borrowed is set aside at the time of the arrangement solely for the person requesting the security. Should we define "arrangement to borrow" as requiring a contract between the broker-dealer and the lending source?
- Should temporary Rule 204T(b) require that participants and broker-dealers from which participants receive trades for clearance and settlement borrow securities prior to effecting further short sales, rather than allowing for either an arrangement to borrow or a borrow? If a fail to deliver position has not been closed out in accordance with

temporary Rule 204T, should we prohibit the participant, and any broker-dealer from which it receives trades for clearance and settlement, from effecting any further short sales until the fail to deliver position has been closed out?

- o If a participant becomes subject to the requirements of temporary Rule 204T(b), the participant will be required to borrow or arrange to borrow securities prior to settlement at a registered clearing agency of the purchase to close out the fail to deliver position. What are the costs associated with this requirement?
- o Temporary Rule 204T(c) imposes a notification requirement on participants. Will such a notification requirement impose operational or systems costs on participants? What types of communication mechanisms will participants use to comply with this requirement of the temporary rule? What will be the costs and benefits of this notification requirement?
- o The temporary rule allows a broker-dealer to obtain pre-fail credit if it purchases securities in accordance with the conditions specified in temporary Rule 204T(e). Are there any operational or compliance concerns associated with the conditions of temporary Rule 204T(e)? To what extent, if any, will temporary Rule 204T(e) encourage broker-dealers to close out a fail to deliver position prior to the Close-Out Date?
- o The temporary rule does not propose amendments to the "locate" requirement of Rule 203(b)(1) of Regulation SHO. In addition to the temporary rule, should we also require that broker-dealers arrange to borrow, or borrow, equity securities prior to effecting short sales in those equity securities? How would this impact the liquidity and availability of such equity securities overall? How would this affect lending rates for such equity securities?

- The temporary rule imposes a close-out requirement on fails to deliver for all equity securities. Due to this hard delivery requirement is it necessary to retain the "locate" requirement of Regulation SHO for short sales? What are the benefits of continuing to require that broker-dealers have a reasonable grounds to believe that a security can be borrowed so that it can be delivered by settlement date if a participant is required to immediately close out a fail to deliver position by no later than the beginning of regular trading hours on the Close-Out Date?
- The temporary rule does not allow any exceptions for fails to deliver due to mechanical aspects of corporate events, such as equity offers, including initial public offerings ("IPOs"),[99] and tender offers. Will the temporary rule cause any disruption to these corporate events? For example, will the temporary rule interfere with the ability of underwriters to provide price support? Would any disruption warrant an exception for certain corporate events? If so, should the exception focus on particular corporate events and why? How much time is needed for securities subject to such corporate events to be delivered? Would providing exceptions for such securities create opportunities for price manipulation?

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[99] See Amy Edwards and Kathleen Weiss Hanley, Short Selling in Initial Public Offerings (2008) http://ssrn.com/abstract=981242 showing that fails to deliver in IPOs are not from "naked" short selling but instead seem to be related to fails to deliver resulting from long sales that result from underwriter price support. The aggregate fails to deliver in these stocks seem to persist for the typical price support period. Thus, the temporary rule's close-out requirement could apply to a high proportion of such fails to deliver, potentially as much as 2.5% of the shares offered on average. Edwards and Hanley believe that such a result could have a substantial impact on the aftermarket of IPOs.

VII. Paperwork Reduction Act

A. Background

Temporary Rule 204T contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("Paperwork Reduction Act").[100] We submitted these requirements to the Office of Management and Budget ("OMB") for review and approval in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13. Separately, we have submitted the collection of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The OMB has approved the collection of information on an emergency basis with an expiration date of April 30, 2009. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: "Temporary Rule 204T" and the OMB control number for the collection of information is 3235-0647.

Temporary Rule 204T will substantially restrict the practice of "naked" short selling in all equity securities by strengthening the delivery requirements for such securities.[101] Temporary Rule 204T(a) amends Regulation SHO to require that participants of a clearing agency registered with the Commission deliver securities by settlement date, or if the participants have not delivered shares by settlement date, the participants must, by no later than the beginning of regular trading hours on the settlement day following the settlement date (the "Close-Out Date"),

[100] 44 U.S.C. 3501 et seq.

[101] As noted above, in a "naked" short sale, the short seller does not borrow or arrange to borrow securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver securities to the buyer when delivery is due.

immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.

A participant that does not comply with the temporary rule's close-out requirements will have violated temporary Rule 204T. In addition, the participant and any broker-dealer from which it receives trades for clearance and settlement, will not be able to short sell the security either for itself or for the account of another, unless it has previously arranged to borrow or has borrowed the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.[102]

Several provisions under temporary Rule 204T will impose a new "collection of information" within the meaning of the Paperwork Reduction Act. These collections of information are mandatory for broker-dealers relying on the rule. The information collected will be retained and/or provided to other entities pursuant to the specific rule provisions and will be available to the Commission and SRO examiners upon request. The information collected will aid the Commission and SROs in monitoring compliance with the rule's requirements.

1. Allocation Notification Requirement

Similar to Rule 203(b)(3)(vi) of Regulation SHO, temporary Rule 204T(d) provides that a participant may reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears or from which the participant receives trades for settlement.[103] Unlike Rule 203(b)(3)(vi) of Regulation SHO, however, temporary Rule

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[102] See temporary Rule 204T(b).

[103] See 17 CFR 242.203(b)(3)(vi). Rule 203(b)(3)(vi) provides that "[i]f a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this paragraph (b)(3) relating to such fail to deliver position shall apply to the

204T(d) imposes an additional notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements (the "allocation notification requirement").[104]

Specifically, temporary Rule 204T(d) provides that a broker or dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of temporary Rule 204T(a) must immediately notify the participant that it has become subject to the borrowing requirements of temporary Rule 204T(b).[105] This allocation notification requirement is designed to help ensure that participants that receive trades for clearance and settlement from broker-dealers will be on notice that the broker-dealer is subject to the borrow requirements of temporary Rule 204T(b) until the fail to deliver position has been closed out.

Such notification will require a broker-dealer to determine that it has a fail to deliver that does not comply with the provisions of temporary Rule 204T(a) and, therefore, has become subject to the requirements of temporary Rule 204T(b). After making such determination, the temporary rule requires that the broker-dealer notify such participant regarding this information.

We estimate that such procedures will take a broker-dealer no more than approximately 0.16 hours (10 minutes) to complete. We base this estimate in part on the fact that, in accordance with Rule 203(b)(3)(vi) of Regulation SHO, participants are permitted to allocate responsibility to close out a portion of a fail to deliver position to a broker-dealer that is responsible for the fail to deliver position; the fact that most broker-dealers already have the necessary communication mechanisms in place and are already familiar with notification

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portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant."

[104] See temporary Rule 204T(d).

[105] See id.

processes and procedures to comply with the borrowing requirements of Rule 203(b)(3)(iv) of Regulation SHO for threshold securities; and the fact that broker-dealers will be able to continue to use the same communication mechanisms, processes and procedures to comply with the notification requirement of temporary Rule 204T(b). On average, participants estimate that currently it takes approximately 0.16 hours (10 minutes) to notify broker-dealers pursuant to Rule 203(b)(3)(iv) of Regulation SHO.[106]

If a broker-dealer has been allocated a portion of a fail to deliver position in an equity security and after the beginning of regular trading hours on the Close-Out Date, the broker-dealer has to determine whether or not that portion of the fail to deliver position was not closed out in accordance with temporary Rule 204T(a), we estimate that a broker-dealer will have to make such determination with respect to approximately 1.76 equity securities per day.[107]

As of December 31, 2007, there were 5,561 registered broker-dealers. Each of these broker-dealers could clear trades through a participant of a registered clearing agency and, therefore, become subject to the notification requirements of temporary Rule 204T(b). We estimate a total of 2,466,415 notifications in accordance with temporary Rule 204T(b) across all broker-dealers (that were allocated responsibility to close out a fail to deliver position) per year

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106 We base this estimate on information provided to our staff by three small, three medium, and three large registered clearing agency participants.

107 OEA estimates that there are approximately 9,809 fail to deliver positions per settlement day. Across 5,561 broker-dealers, the number of securities per broker-dealer per day is approximately 1.76 equity securities. During the period from January to July 2008, approximately 4,321 new fail to deliver positions occurred per day. The NSCC data for this period includes only securities with at least 10,000 shares in fails to deliver. To account for securities with fails to deliver below 10,000 shares, the figure is multiplied by a factor of 2.27. The factor is estimated from a more complete data set obtained from NSCC during the period from September 16, 2008 to September 22, 2008. It should be noted that these numbers include securities that were not subject to the close-out requirement of Rule 203(b)(3) of Regulation SHO.

(5,561 broker-dealers notifying participants once per day[108] on 1.76 securities, multiplied by 252 trading days in a year). The total estimated annual burden hours per year will be approximately 394,626 burden hours (2,466,415 multiplied by 0.16 hours/notification). We estimate that the paperwork compliance for the allocation notification requirement for each broker-dealer will be approximately 71.0 burden hours per year.

2. Demonstration Requirement for Fails to Deliver on Long Sales

Temporary Rule 204T(a)(1) includes an exception from temporary rule's close-out requirement for fail to deliver positions resulting from long sales of all equity securities. Under this exception, if a participant has a fail to deliver position at a registered clearing agency in an equity security and can demonstrate on its books and records that such fail to deliver position resulted from a long sale (the "demonstration requirement for fails to deliver on long sales"), such participant will have until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date to immediately close out the fail to deliver position by purchasing securities of like kind and quantity.[109]

This provision allows a participant an additional two settlement days in which to close out the fail to deliver position that resulted from a long sale, provided that the participant's books and records reflect the fact that the fail to deliver resulted from a long sale.[110]

The demonstration requirement will require a participant of a registered clearing agency to determine whether it has a fail to deliver position at a registered clearing agency in an equity security that resulted from a long sale. After making such determination, the temporary rule

[108] Because failure to comply with the close-out requirements of temporary Rule 204T(a) is a violation of the temporary rule, we believe that a broker-dealer would make the notification to a participant that it is subject to the borrowing requirements of temporary Rule 204T(b) at most once per day.

[109] See temporary Rule 204T(a)(1).

[110] See id.

requires that the participant demonstrate or reflect this information in its books and records. We estimate that such procedures will take a participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to complete.

We base this estimate on the fact that, to comply with Regulation SHO's marking requirements, broker-dealers are already required to ascertain whether a customer is "deemed to own" the securities being sold before marking a sell order "long" and, if the securities are not in the broker-dealer's physical possession or control, whether the broker-dealer reasonably expects that the shares will be in the broker-dealer's physical possession or control by settlement date.[111] This reasonableness determination includes consideration of whether or not a prior sale resulted in a fail to deliver position. In addition, broker-dealers already must comply with the documentation requirement contained in the "locate" requirement of Rule 203(b)(1) of Regulation SHO. Participants will be able to use similar mechanisms, processes and procedures to demonstrate compliance with the temporary rule's close-out requirement for fails to deliver resulting from long sales as they use for compliance with the current requirements of Regulation SHO.

If a participant of a registered clearing agency has a fail to deliver position in an equity security at a registered clearing agency and determined that such fail to deliver position resulted from a long sale, we estimate that a participant of a registered clearing agency will have to make such determination with respect to approximately 34 securities per day.[112]

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[111] See 17 CFR 242.200(g)(1).

[112] OEA estimates approximately 68% of trades are long sales and applies this percentage to the number of fail to deliver positions per day. 68% of 50 securities per day is 34 securities per day. The 68% figure is estimated as 100% minus the proportion of short sale trades found in the Regulation SHO Pilot Study. See http://www.sec.gov/news/studies/2007/regshopilot020607.pdf.

As of July 31, 2008, there were 197 participants of NSCC, the primary registered clearing agency responsible for clearing U.S. transactions that were registered as broker-dealers. We estimate a total of 1,687,896 demonstrations in accordance with temporary Rule 204T(a)(1) across all participants per year (197 participants checking for compliance once per day on 34 securities, multiplied by 252 trading days in a year). The total approximate estimated annual burden hour per year will be approximately 270,063 burden hours (1,687,896 multiplied by 0.16 hours/documentation). We estimate that the paperwork burden for the temporary demonstration provision for each participant will be approximately 1,371 burden hours per year.

3. Pre-Borrow Notification Requirement

The borrowing requirements of temporary Rule 204T(b) are similar to the requirements of Rule 203(b)(3)(iv) of Regulation SHO for a participant that has failed to close out a fail to deliver position in a threshold security that has persisted for thirteen consecutive settlement days.[113] Unlike the current borrow requirements of Rule 203(b)(3)(iv) of Regulation SHO, however, temporary Rule 204T(c) specifies that participants must notify all broker-dealers from which they receive trades for clearance and settlement that a fail to deliver position has not been closed out in accordance with temporary Rule 204T(a) (the "pre-borrow notification requirement").

Specifically, temporary Rule 204T(c) provides that the participant must notify any broker or dealer from which it receives trades for clearance and settlement, including any market maker

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[113] See 17 CFR 242.203(b)(3)(iv). Rule 203(b)(3)(iv) of Regulation SHO provides that "[i]f a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of this section, may not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity."

that would otherwise be entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,[114] (1) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of temporary Rule 204T(a), and (2) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.[115]

The notification requirement will involve a participant of a registered clearing agency determining whether it has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of temporary Rule 204T(a), and when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency. After making such determinations, the temporary rule requires that the participant notify such broker-dealer regarding this information.

We estimate that such procedures will take a participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to complete.[116] We base this estimate in part on the fact that most participants already notify broker-dealers for which they receive orders for clearance and settlement that the participant has a fail to deliver position in a threshold security that has not been closed out in order to comply with the borrow requirements of Rule 203(b)(3)(iv) of Regulation SHO for threshold securities; the fact that most participants already have the necessary communication mechanisms in place and are already familiar with notification processes and procedures to comply with the borrow requirements of Rule

[114] See 17 CFR 203(b)(2)(iii) (providing for an exception from the "locate" requirement for market makers engaged in bona fide market making in that security at the time of the short sale).

[115] See temporary Rule 204T(c).

[116] We base this estimate on information provided to our staff by three small, three medium, and three large registered clearing agency participants.

203(b)(3)(iv) of Regulation SHO for threshold securities; and the fact that participants will be able to continue to use the same communication mechanisms, processes and procedures to notify any broker-dealers from which they receive trades for clearance and settlement of the information required by the temporary rule's notification requirement as they use for compliance with Regulation SHO.

If a participant of a registered clearing agency has a fail to deliver position in an equity security and after the beginning of regular trading hours on the Close-Out Date (or, in the case of a fail to deliver that resulted from a long sale, on the third consecutive settlement day following the settlement date), the participant has to determine whether or not the fail to deliver position was closed out in accordance with temporary Rule 204T(a), we estimate that a participant of a registered clearing agency will have to make such determination with respect to approximately 50 equity securities per day.[117]

As of July 31, 2008, there were 197 participants of NSCC, the primary registered clearing agency responsible for clearing U.S. transactions that were registered as broker-dealers.[118] We estimate a total of 2,482,200 notifications in accordance with temporary Rule 204T(c) across all

[117] OEA estimates that there are approximately 9,809 fail to deliver positions per day. Across 197 broker-dealer participants of the NSCC, the number of securities per participant per day is approximately 50 equity securities. During the period from January to July 2008, approximately 4,321 new fail to deliver positions occurred per day. The NSCC data for this period includes only securities with at least 10,000 shares in fails to deliver. To account for securities with fails to deliver below 10,000 shares, the figure is grossed-up by a factor of 2.27. The factor is estimated from a more complete data set obtained from NSCC during the period from September 16, 2008 to September 22, 2008. It should be noted that these numbers include securities that were not subject to the close-out requirement of Rule 203(b)(3) of Regulation SHO.

[118] Those participants not registered as broker-dealers include such entities as banks, U.S.-registered exchanges, and clearing agencies. Although these entities are participants of a registered clearing agency, generally these entities do not engage in the types of activities that will implicate the close-out requirements of the temporary rule. Such activities of these entities include creating and redeeming Exchange Traded Funds, trading in municipal securities, and using NSCC's Envelope Settlement Service or Inter-city Envelope Settlement Service. These activities rarely lead to fails to deliver and, if fails to deliver do occur, they are small in number and are usually closed out within a day. Thus, such fails to deliver will not trigger the close-out requirement of the temporary rule.

participants per year (197 participants notifying broker-dealers once per day on 50 securities, multiplied by 252 trading days in a year). The total estimated annual burden hours per year will be approximately 397,152 burden hours (2,482,200 @ 0.16 hours/documentation). We estimate that the paperwork burden for the notification requirement for each participant will be approximately 2,016 burden hours per year.

4. Certification Requirement

The temporary rule includes an exception from the borrowing requirements for any broker-dealer that can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. Specifically, temporary Rule 204T(b)(1) provides that a broker or dealer shall not be subject to the requirements of temporary Rule 204T(b) if the broker or dealer timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with the requirements of temporary Rule 204T(e) (the "certification requirement").[119]

This certification requirement will allow a broker-dealer to avoid being subject to the temporary rule's borrowing requirements if it can demonstrate that it did not incur a fail to deliver position in the security on settlement date. Also, by requiring the broker-dealer to demonstrate that it was not responsible for any part of the fail to deliver position of the participant, the information collected will help ensure that broker-dealers are complying with the requirements of the temporary rule.

This certification requirement will require a broker-dealer to determine that it has not incurred a fail to deliver position on settlement date in an equity security for which the

[119] See temporary Rule 204T(b)(1).

participant has a fail to deliver position at a registered clearing agency or that the broker-dealer is in compliance with the requirements set forth in the Pre-Fail Credit provision of temporary Rule 204T(e). After making such determinations, the broker-dealer will have to certify this information to the participant. We estimate that such procedures will take a broker-dealer no more than approximately 0.16 hours (10 minutes) to complete.

We base this estimate, in part, on the fact that, to comply with the close-out requirements of Rule 203(b) of Regulation SHO, current industry practice for some participants that are registered broker-dealers is to document purchases made on settlement days 11, 12, and 13 to demonstrate that such participants do not have a close-out obligation under Regulation SHO. On average, participants informed us that such documentation takes approximately 0.16 hours (10 minutes).[120]

If the broker-dealer determines that it has not incurred a fail to deliver position on settlement date in an equity security for which the participant has a fail to deliver position at a registered clearing agency or has purchased securities in accordance with the conditions specified in temporary Rule 204T(e), we estimate that a broker-dealer will have to make such determinations with respect to approximately 1.76 securities per day. As of December 31, 2007, there were 5,561 registered broker-dealers. Each of these broker-dealers may clear trades through a participant of a registered clearing agency. We estimate that on average, a broker-dealer will have to certify to the participant that it has not incurred a fail to deliver position on settlement date in an equity security for which the participant has a fail to deliver position at a registered clearing agency or, alternatively, that it is in compliance with the requirements set forth in the Pre-Fail Credit provision of the temporary Rule 204T(e), 2,466,415 times per year

[120] We base this estimate on information provided to our staff by three small, three medium, and three large registered clearing agency participants.

(5,561 broker-dealers certifying once per day on 1.76 securities, multiplied by 252 trading days in a year). The total approximate estimated annual burden hour per year will be approximately 394,626 burden hours (2,466,415 multiplied by 0.16 hours/certification). We estimate that the paperwork burden for the certification provision for each broker-dealer will be approximately 71.0 burden hours per year.

5. Pre-Fail Credit Demonstration Requirement

To encourage close outs of fail to deliver positions prior to the Close-Out Date, temporary Rule 204T(e) provides that a broker-dealer can satisfy the temporary rule's close-out requirement by purchasing securities in accordance with the conditions of that provision (i.e., broker-dealers will receive "pre-fail credit" for the purchase), including a condition that the broker-dealer demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is claiming credit (the "Pre-Fail Credit demonstration requirement").

Temporary Rule 204T(e) provides that even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with temporary Rule 204T(a), or has not allocated a fail to deliver position to a broker-dealer in accordance with temporary Rule 204T(d), a broker or dealer may receive credit for purchasing securities prior to the beginning of regular trading hours on the Close-Out Date if, among other things, the purchase is executed on, or after, trade date but by no later than the end of regular trading hours on settlement date and the broker or dealer can demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is claiming credit.[121]

[121] See temporary Rule 204T(e).

The Pre-Fail Credit provision is intended to encourage broker-dealers to close out fail to deliver positions prior to the beginning of regular trading hours on the Close-Out Date. By requiring, among other things, that the broker-dealer demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker-dealer is claiming credit, the information collected will help ensure that broker-dealers purchase sufficient shares to close out their fail to deliver position prior to the beginning of regular trading hours on the Close-Out Date.

Such demonstration requirement will require a broker-dealer that purchased securities in accordance with the conditions specified in temporary Rule 204T(e) to determine that it has a net long position or net flat position on the settlement day for which the broker-dealer is claiming credit. After making such determination, the temporary rule requires that the broker-dealer demonstrate such information on its books and records. We estimate that such procedures will take a broker-dealer no more than approximately 0.16 hours (10 minutes) to complete.

We base this estimate on the fact that, to comply with the close-out requirement of Rule 203(b)(3) of Regulation SHO, current industry practice for some participants that are registered broker-dealers is to document purchases made on settlement days 11, 12, and 13 to demonstrate that such participants do not have a close-out obligation under Regulation SHO. On average, participants informed us that such documentation takes approximately 0.16 hours (10 minutes).[122]

If a broker-dealer purchased securities in accordance with the conditions specified in temporary Rule 204T(e) and determined that it has a net long position or net flat position on the

[122] We base this estimate on information provided to our staff by three small, three medium, and three large registered clearing agency participants.

settlement day for which the broker-dealer is claiming credit, we estimate that a broker-dealer will have to make such determination with respect to approximately 1.76 securities per day.[123]

As of December 31, 2007, there were 5,561 registered broker-dealers. We estimate that on average, a broker-dealer will have to demonstrate in its books and records that it has a net long position or net flat position on the settlement day for which the broker-dealer is claiming credit, 2,466,415 times per year (5,561 broker-dealers checking for compliance once per day on 1.76 securities, multiplied by 252 trading days in a year). The total approximate estimated annual burden hour per year will be approximately 394,626 burden hours (2,466,415 multiplied by 0.16 hours/demonstration). We estimate that the paperwork burden for the temporary Pre-Fail Credit provision for each broker-dealer will be approximately 71.0 burden hours per year.

6. Market Maker Demonstration Requirement

To allow market makers to facilitate customer orders in a fast moving market, the temporary rule includes a limited exception from the rule's close-out requirement for fails to deliver attributable to bona fide market making activities by registered market makers, options market makers, or other market makers obligated to quote in the over-the-counter market (collectively, "Market Makers"). Under this exception, a participant must close out the fail to deliver position attributable to a Market Maker by no later than the beginning of regular trading hours on the morning of the third settlement day after the settlement date for the transaction that resulted in the fail to deliver position. The borrowing requirements of the temporary rule do not apply to Market Makers provided the Market Maker can demonstrate that it does not have an open fail to deliver position at the time of any additional short sales (the "Market Maker demonstration requirement").

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[123] See supra, note 107.

By requiring a Market Maker to demonstrate that it does not have an open fail to deliver position at the time of any additional short sales and, thus, avoid being subject to the temporary rule's pre-borrow requirements, the information collected will help ensure that Market Makers are complying with the requirements of temporary Rule 204T(b)(2).

This requirement will require a Market Maker to determine whether it has an open fail to deliver position at the time of any additional short sales in the particular equity security in which there is a fail to deliver position at a registered clearing agency. After making such a determination, the temporary rule requires that the Market Maker demonstrate that it does not have an open fail to deliver position in that equity security. We estimate that such procedures will take a Market Maker no more than approximately 0.16 hours (10 minutes) to complete.[124]

If a participant of a registered clearing agency has a fail to deliver position in an equity security at a registered clearing agency that is attributable to a Market Maker and the Market Maker, in seeking to avoid the borrowing requirements of temporary Rule 204T(b), has determined that it does not have an open fail to deliver position, we estimate that such Market Maker will have to make such determination with respect to approximately 15 securities per day.[125]

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124 We base this estimate on information provided to our staff by three large, three medium, and three small firms that engage in market making activities currently complying with temporary Rule 204T, pursuant to the September Emergency Order, which has similar requirements to temporary Rule 204(T)(b)(2) of this release.

125 OEA estimates that there are approximately 9,809 fail to deliver positions per day. An upper bound on the number of fail to deliver positions per day due to market makers is 9,809. Across 656 market makers, the number of securities per market maker per day is approximately 15 equity securities. During the period from January to July 2008, approximately 4,321 new fail to deliver positions occurred per day. The NSCC data for this period includes only securities with at least 10,000 shares in fails to deliver. To account for securities with fails to deliver below 10,000 shares, the figure is grossed-up by a factor of 2.27. The factor is estimated from a more complete data set obtained from NSCC during the period from September 16, 2008 to September 22, 2008. It should be noted that these numbers include securities that were not subject to the close-out requirement of Rule 203(b)(3) of Regulation SHO.

As of December 31, 2007, there were 656 Market Makers.[126] We estimate a total of 2,479,680 written demonstrations in accordance with temporary Rule 204T(b)(1) across all Market Makers per year (656 Market Makers demonstrating once per day on 15 securities, multiplied by 252 trading days in a year). The total estimated annual burden hour per year will be approximately 396,749 burden hours (2,479,680 multiplied by 0.16 hours/demonstration). We estimate that the paperwork burden for the Market Maker demonstration requirements for each Market Maker will be approximately 604.8 burden hours per year.

B. Request for Comment

We invite comment on these estimates and assumptions. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to: (a) evaluate whether the collection of information is necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimate of the burden of the collection of information; (c) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (d) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with

[126] These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

reference to File No. S7-30-08. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7-30-08, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549-1090. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VIII. Cost-Benefit Analysis

A. Summary

The Commission is sensitive to the costs and benefits of its rules. Commenters should provide analysis and data to support their views on the costs and benefits associated with the temporary rule.

We are adopting, as an interim final temporary rule, Rule 204T, under the Exchange Act. The temporary rule is intended to address abusive "naked" short selling in all equity securities by requiring that participants of a registered clearing agency deliver securities by settlement date, or if the participants have not delivered shares by settlement date, the participants must, by no later than the beginning of regular trading hours on the Close-Out Date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.

If a participant does not purchase or borrow shares, as applicable, to close out a fail to deliver position in accordance with temporary Rule 204T(a), the participant will have violated the temporary rule. In addition, the temporary rule imposes on the participant for its own trades and on all broker-dealers from which that participant receives trades for clearance and settlement (including introducing and executing brokers), a requirement to borrow or arrange to borrow securities prior to accepting or effecting further short sales in that security.[127]

To the extent that a participant becomes subject to the borrowing requirements of temporary Rule 204T(b), a broker-dealer that clears through the participant can avoid being subject to the borrowing requirements of temporary Rule 204T(b) if the broker-dealer can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. Moreover, to allow Market Makers to facilitate customer orders in a fast moving market without possible delays associated with complying with the pre-borrow penalty provision of temporary Rule 204T(b), the borrowing requirements of the temporary rule do not apply to Market Makers provided the Market Maker can show that it does not have an open fail to deliver position at the time of any additional short sales.[128]

Similar to Rule 203(b)(3)(vi) of Regulation SHO, temporary Rule 204(d) provides that a participant may reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears trades, or from which it receives trades for settlement.[129] Unlike Rule 203(b)(3)(vi) of Regulation SHO, however, temporary Rule 204T(d) imposes a notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements.[130]

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127 See temporary Rule 204T(b).

128 See temporary Rule 204T(b)(2).

129 See 17 CFR 242.203(b)(3)(vi). Rule 203(b)(3)(vi) provides that "[i]f a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this paragraph (b)(3) relating to such fail to deliver position shall apply to the portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant."

130 See temporary Rule 204T(d).

In addition, the temporary rule provides that if a participant has a fail to deliver position at registered clearing agency in an equity security and can demonstrate on its books and records that such fail to deliver position resulted from a long sale, such participant has until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date to immediately close out the fail to deliver position by purchasing securities of like kind and quantity.

The temporary rule also extends the close-out requirement for fails to deliver attributable to bona fide market making activities by Market Makers by requiring a participant to close out the fail to deliver position attributable to a Market Maker by no later than the beginning of regular trading hours on the third settlement day after the settlement date for the transaction that resulted in the fail to deliver position.

In addition, consistent with Rule 203(b)(3)(ii) of Regulation SHO, the temporary rule includes an exception for sales of securities pursuant to Rule 144 of the Securities Act.[131] Specifically, temporary Rule 204T(a)(2) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security sold pursuant to Rule 144 for thirty-five consecutive settlement days after the settlement date for a sale in that equity security, the participant shall, by no later than the beginning of regular trading hours on the thirty-sixth consecutive settlement day following the settlement date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.[132]

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131 See 17 CFR 242.203(b)(3)(ii).

132 See temporary Rule 204T(a)(2).

If, however, a fail to deliver position resulting from the sale of an equity security pursuant to Rule 144 is not closed out in accordance with temporary Rule 204T(a)(2), the participant is subject to the borrow requirements in temporary Rule 204T(b). Thus, if the fail to deliver position persists beyond thirty-five consecutive settlement days, the temporary rule prohibits a participant of a registered clearing agency, and any broker-dealer from which it receives trades for clearance and settlement, from accepting any short sale orders or effecting further short sales in the particular security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.[133]

Although we recognize the temporary rule may impose increased borrowing costs to assure settlement in accordance with the requirements of the temporary rule, which may increase the costs of legitimate short selling, we believe that the requirements of the temporary rule are necessary to achieve our goal of further reducing fails to deliver and addressing abusive "naked" short selling.

B. Benefits

The temporary rule will substantially restrict the practice of "naked" short selling in all equity securities by strengthening the delivery requirements for such securities. By requiring that participants of a registered clearing agency deliver securities by settlement date, or if the participants have not delivered shares by settlement date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity, the temporary rule also furthers our goals of limiting fails to deliver and helping to reduce the possibility that

[133] See temporary Rule 204T(b).

abusive "naked" short selling may contribute to disruption in the securities markets. This, in turn, will help to ensure that investors remain confident that trading can be conducted without the influence of illegal manipulation. The temporary rule also furthers the goals of helping to maintain fair and orderly markets against the threat of sudden and excessive fluctuations of securities prices and substantial disruption in the functioning of the securities markets. The temporary rule also promotes the prompt and accurate clearance and settlement of transactions in equity securities.

In addition, the temporary rule will help to further reduce the number of fails to deliver. These fails may create a misleading impression of the market for these securities. Large and persistent fails to deliver may have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. Thus, by facilitating the prompt receipt of shares, the temporary rule will help enable investors to receive the benefits associated with share ownership.

Persistent fails to deliver in a security may also be perceived by potential investors negatively and may affect their decision about making a capital commitment. Thus, by providing greater assurance that securities will be delivered and, thereby, alleviating investor apprehension as they make investment decisions, the temporary rule will benefit issuers in that an increase in investor confidence in the market for their securities will facilitate investment in their securities.

1. Close-out Requirements

By requiring that participants of a registered clearing agency deliver securities by settlement date, or if the participants have not delivered shares by settlement date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity, the temporary rule will help restore, maintain, and enhance investor confidence in the securities markets. It will also help reduce manipulative schemes involving "naked" short selling in equity securities. Sellers that fail to deliver securities on settlement date may enjoy fewer restrictions than if they were required to deliver the securities within a reasonable period of time, and such sellers may attempt to use this additional freedom to engage in trading activities that deliberately depress the price of a security. Thus, the temporary rule's close-out requirements are expected to remove a potential means of manipulation, thereby decreasing the possibility of artificial market influences and contributing to price efficiency.

Under temporary Rule 204T(a)(1), a participant that has a fail to deliver position at a registered clearing agency in an equity security and can demonstrate on its books and records that such fail to deliver position resulted from a long sale, will have until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date to immediately close out the fail to deliver position by purchasing securities of like kind and quantity. This provision allows participants an additional two settlement days to close out fail to deliver positions that result from long sales, provided that the participant's books and records reflect the fact that the fail to deliver resulted from a long sale.[134] We believe this exception to temporary Rule 204T(a)'s close-out requirement benefits participants because the two additional days to close-out these fail to deliver positions may reduce close-out costs for such participants.

The temporary rule also extends temporary Rule 204T(a)'s close-out requirement for fails to deliver attributable to bona fide market making activities by Market Makers by requiring a participant to close out the fail to deliver position attributable to a Market Maker by no later than

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[134] See temporary Rule 204T(a)(1).

the beginning of regular trading hours on the third settlement day after the settlement date. We believe this exception to temporary Rule 204T(a)'s close-out requirement benefits participants because the two additional days to close-out these fail to deliver positions may reduce close-out costs for such participants.

Similar to Rule 203(b)(3)(vi) of Regulation SHO, temporary Rule 204(d) allows a participant to reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears trades, or from which it receives trades for settlement. This allocation provision benefits participants because if a participant can identify the accounts of broker-dealers for which they clear or from which they receive trades for settlement, the participant can allocate the responsibility to close out the fail to deliver position to the particular broker-dealer account(s) whose trading activities caused the fail to deliver position provided the allocation is reasonable and, therefore, the allocated broker-dealer rather than the participant will incur any costs associated with the temporary rule's close-out requirement.

In addition, temporary Rule 204T(d) imposes a notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements. Thus, under the temporary rule's allocation provision, if the broker-dealer does not comply with the provisions of temporary Rule 204T(a), it must immediately notify the participant that it has become subject to the borrowing requirements of temporary Rule 204T(b).[135] This allocation notification requirement is intended to let participants know when a broker-dealer from which the participant receives trades for clearance and settlement has become subject to the temporary rule's borrowing requirements. The notification requirement furthers the Commission's goals of limiting fails to deliver and addressing abusive "naked" short selling by promoting the prompt

[135] See temporary Rule 204T(d).

and accurate clearance and settlement of transactions involving equity securities. The notification requirement will also help ensure that participants that receive trades for clearance and settlement from broker-dealers will be on notice that the broker-dealer is subject to the borrow requirements of temporary Rule 204T(b) until the fail to deliver position has been closed out.

Moreover, under the temporary rule's Pre-Fail Credit provision, a broker or dealer may receive credit for purchasing securities prior to the beginning of regular trading hours on the Close-Out Date if, among other things, the purchase is executed on, or after, trade date but by no later than the end of regular trading hours on settlement date and the broker or dealer can demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is claiming credit. The Pre-Fail Credit provision is intended to encourage earlier close out of fails to deliver in all equity securities and, therefore, to the extent used could result in a reduction of persistent fails to deliver.

2. Borrowing Requirements

The borrowing requirements of temporary Rule 204T(b) are similar to the requirements of Rule 203(b)(3)(iv) of Regulation SHO for a participant that has not closed out a fail to deliver position in a threshold security that has persisted for thirteen consecutive settlement days.[136] Similar to Regulation SHO, the temporary rule is aimed in part at addressing potentially abusive "naked" short selling in equity securities. To that end, we believe it is appropriate to include in the temporary rule borrowing requirements for broker-dealers, including participants, that sell short a security that has a fail to deliver position that has not been closed out in accordance with the requirements of the temporary rule. We believe that the borrowing requirements of

[136] See 17 CFR 242.203(b)(3)(iv).

temporary Rule 204T(b) will further our goal of limiting fails to deliver and addressing abusive "naked" short selling by promoting the prompt and accurate clearance and settlement of transactions in equity securities. By requiring that participants and broker-dealers from which they receive trades for clearance and settlement borrow or arrange to borrow securities prior to accepting or effecting short sales in the security that has a fail to deliver position that has not been closed out, the temporary rule will help to ensure that shares will be available for delivery on the short sale by settlement date and, thereby, help to avoid additional fails to deliver occurring in the security.

Unlike the current borrow requirements of Rule 203(b)(3)(iv) of Regulation SHO, however, the borrow requirements of the temporary rule specify that participants must notify all broker-dealers from which they receive trades for clearance and settlement that a fail to deliver position in an equity security has not been closed out in accordance with temporary Rule 204T(a).[137] This notification requirement in temporary Rule 204T(c) is intended to ensure that all broker-dealers that submit trades for clearance and settlement to a participant that has a fail to deliver position in an equity security that has not been closed out in accordance with temporary Rule 204T(a) are on notice that all short sales in that security will be subject to the borrowing requirements of temporary Rule 204T(b) until the fail to deliver position has been closed out.

However, if a participant becomes subject to the borrowing requirements of temporary Rule 204T(b) because it did not close out a fail to deliver position by no later than the beginning of regular trading hours on the settlement date for the transaction, a broker-dealer that clears through the participant will not also be subject to the borrowing requirements of temporary Rule 204T(b) if the broker-dealer can demonstrate that it was not responsible for any part of the fail to

[137] See temporary Rule 204T(c).

deliver position of the participant.[138] This exception allows a broker-dealer to avoid being subject to the borrowing requirements of the temporary rule if the broker-dealer can demonstrate that it did not incur a fail to deliver position in the security on settlement date.

Moreover, the borrowing requirements of the temporary rule will not apply to Market Makers, provided that the Market Maker can show that it does not have an open fail to deliver position at the time of any additional short sales.[139] This provision is intended to allow Market Makers to facilitate customer orders in a fast moving market without possible delays associated with complying with the pre-borrow penalty provision of temporary Rule 204T(b).

3. Sales of Securities Pursuant to Rule 144

Securities sold pursuant to Rule 144 of the Securities Act are formerly restricted securities that a seller is "deemed to own," as defined by Rule 200(a) of Regulation SHO.[140] The securities, however, may not be capable of being delivered on the settlement date due to processing delays related to removal of the restricted legend and, therefore, sales of these securities frequently result in fails to deliver. Consistent with our statements in connection with our recent amendments to Regulation SHO in connection with closing out fails to deliver in threshold securities sold pursuant to Rule 144,[141] we believe that a close-out requirement of thirty-five consecutive settlement days from settlement date for fails to deliver resulting from sales of equity securities sold pursuant to Rule 144, will permit the orderly settlement of such sales without the risk of causing market disruption due to unnecessary purchasing activity

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[138] See temporary Rule 204T(b)(1).

[139] See temporary Rule 204T(b)(2).

[140] See 17 CFR 242.200(a).

[141] As mentioned above, we recently adopted amendments to the close-out requirement of Regulation SHO to allow fails to deliver resulting from sales of threshold securities pursuant to Rule 144 to be closed out within 35 rather 13 consecutive settlement days. See 2007 Regulation SHO Final Amendments, 72 FR at 45550-45551.

(particularly if the purchases are for sizable quantities of stock). Because the Rule 144 security sold will be received as soon as all processing delays have been removed, this additional time will allow participants to close out fails to deliver resulting from the sale of the security with the security sold, rather than having to close out such fail to deliver position by purchasing securities in the market. Thus, the amendments will reduce costs to participants and, in turn, investors.

Although the temporary rule allows fails to deliver resulting from sales of equity securities sold pursuant to Rule 144 of the Securities Act thirty-five consecutive settlement days after the settlement date before a participant must take action to close out the fail to deliver position, these fails to deliver must be closed out by no later than the beginning of regular trading hours on the thirty-sixth settlement day and, therefore, these fails to deliver cannot continue indefinitely. Thus, we believe that the temporary rule is consistent with our goal of further reducing fails to deliver in equity securities, while balancing the concerns associated with closing out fails to deliver resulting from sales of securities pursuant to Rule 144 of the Securities Act.

C. Costs

We recognize that the temporary rule may result in increased short selling costs for participants that may impact legitimate short selling activities; however, we believe such costs will be limited. For example, it might result in participants incurring borrowing costs where they borrow securities to close out a fail to deliver position that might have been closed out soon thereafter with shares received from the customer. Such actions might result in added demand in the lending market which in turn might exert upward pressure on securities lending rates, potentially making short selling more expensive for all market participants. For example, it is estimated that about $700 billion in U.S. equity securities are lent out per year. Preliminary input from industry participants suggests that lending rates increased significantly after the

September Emergency Order for stocks not covered by the ban on short selling. While results from the period after the September Emergency Order may be confounded by the unusual circumstances of the continued credit crisis, an increase of 10 basis points in lending rates would result in an annual cost increase to securities borrowers of $700 million and the new revenue for securities lenders increasing by the corresponding amount of $700 million. Therefore, if lending increased by 10 basis points, the annual impact on the securities lending market would be about $1,400 million (or $1,050 million for nine months).

To the extent that the requirements of the temporary rule will result in increased costs to short selling in equity securities, it may lessen some of the benefits of legitimate short selling and, thereby, result in a reduction in short selling generally. Such a reduction may lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less efficient allocation of capital, an increase in trading costs, and a decrease in liquidity. We also recognize that requiring that participants purchase securities to close out fails to deliver in equity securities in accordance with the temporary rule, may potentially impact the willingness of participants to provide liquidity.

As a likely result of the temporary rule as contained in the September Emergency Order, bid-ask spreads on equity securities have increased. Preliminary input from industry participants suggests that bid-ask spreads have increased after the September Emergency Order for stocks not covered by the ban on short selling. While results from the period after the September Emergency Order may be confounded by the unusual circumstances of the continued credit crisis, an increase of 1 basis point in bid-ask spreads would result in an annual cost to investors of about $6,048 million. To calculate the annual cost, we assume that 12 billion shares trade on a daily basis. At an average share price of approximately $20, this constitutes $240 billion in dollar volume per day. Based on this total, an increase in transaction costs of one basis point would result in a daily increase in realized transaction costs of approximately $24 million a day. At this rate, investors would experience increased total transaction costs of over $100 million within the first five trading days of the rule or about $6,048 million annually ($24 million times 252 trading days) (or $4,536 million for nine months).

We believe, however, that strengthening rules against potentially abusive "naked" short selling will provide increased confidence in the securities markets. Thus, although we recognize that the temporary rule may result in increased short selling costs, we believe such costs are justified by the fact that the temporary rule may help restore, maintain, and enhance investor confidence in the markets by preventing potentially abusive "naked" short selling.

1. Close-Out Requirements

We also recognize that requiring that participants purchase securities to close-out fails to deliver in any equity security in accordance with the temporary rule, may potentially impact the willingness of participants to provide liquidity. However, we believe that any such potential effect will be minimal because participants will still have some flexibility by having two additional settlement days in which to purchase securities to close-out their fail to deliver positions that either result from long sales or are attributable to bona fide market making activities by Market Makers.

In addition, we recognize that the temporary rule's close-out requirement may result in some additional costs for participants of a registered clearing agency in terms of systems and surveillance modifications, as well as changes to processes and procedures. However, we believe any additional costs incurred in implementing temporary Rule 204T's close-out requirement in terms of these modifications will be minimal. The close-out requirement of the temporary rule is consistent with the current settlement practices and procedures and with the close-out requirement of Regulation SHO. For example, because most transactions settle by T+3, participants should already have in place policies and procedures to help ensure that delivery is being made by settlement date. Nevertheless, participants will incur costs for each close-out and these costs could accumulate to significant amounts over time and across participants.

Moreover, similar to the existing close-out requirement of Rule 203(b)(3) of Regulation SHO, the temporary rule is based on a participant's fail to deliver position at a registered clearing agency. As noted above, the NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter markets. The NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. The NSCC notifies its members of their securities delivery and payment obligations daily. Thus, because the temporary rule is based on a participant's fail to deliver position at a registered clearing agency, it is consistent with current settlement practices and procedures and with the Regulation SHO framework regarding delivery of securities.[142] As such, we anticipate that most participants will already have systems, processes and procedures in place in order to comply with the temporary rule's close-out requirements and, therefore, that any additional implementation costs associated with the temporary rule will be minimal.

In addition, to comply with Regulation SHO's close-out requirement when it became effective in January 2005, participants needed to modify their recordkeeping systems and surveillance mechanisms. Participants also should have retained and trained the necessary personnel to ensure compliance with the rule's close-out requirements. Thus, most of the infrastructure necessary to comply with the temporary rule's close-out requirement should

[142] See 17 CFR 242.203(b)(3).

already be in place. Thus, we believe that any changes to personnel, computer hardware and software, recordkeeping or surveillance costs will be minimal.

We recognize that the requirements of temporary Rule 204T(a)(1) may also impose additional costs on participants of a registered clearing agency. As discussed above, under temporary Rule 204T(a)(1), a participant of a registered clearing agency that has a fail to deliver position at a registered clearing agency in an equity security and can demonstrate on its books and records that the fail to deliver position resulted from a long sale, will have until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date to immediately close out the fail to deliver position by purchasing securities of like kind and quantity. Thus, to qualify for this additional time to close out a fail to deliver position, the temporary rule requires the participant to demonstrate on their books and records that the fail to deliver position resulted from a long sale.

This demonstration requirement may result in participants incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII above, for purposes of the Paperwork Reduction Act, we estimate that it will take each participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to comply with the demonstration requirement of the temporary Rule 204T(a)(1). In addition, we estimate that the total annual hour burden per year for each participant subject to the documentation requirement will be 1,371 hours.

The allocation notification requirement of temporary Rule 204T(d) will impose costs on broker-dealers that have been allocated responsibility for the close-out requirement under the temporary rule. As discussed above, temporary Rule 204T(d) requires a broker or dealer that has been allocated a portion of a fail to deliver position that has not complied with the close-out provisions under the temporary rule to notify the participant that it has become subject to the borrowing requirements of temporary Rule 204T(b). This notification requirement may result in broker-dealers incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII, above, for purposes of the Paperwork Reduction Act, we estimate that it will take each broker-dealer no more than approximately 0.16 hours (10 minutes) to comply with the notification requirements of temporary Rule 204T(d). In addition, we estimate that the total annual hour burden per year for each broker-dealer subject to the notification requirement will be 71.0 hours.

We also recognize that the requirements of temporary Rule 204T(e) may impose additional costs on broker-dealers. As discussed above, temporary Rule 204T(e) allows a broker-dealer to obtain pre-fail credit if it purchases securities in accordance with the conditions specified in the temporary rule. To receive pre-fail credit, the temporary rule requires, among other things, that a broker-dealer demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is claiming credit.

This demonstration requirement may result in participants incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII above, for purposes of the Paperwork Reduction Act, we estimate that it will take each broker-dealer no more than approximately 0.16 hours (10 minutes) to comply with the demonstration requirements of the temporary rule. In addition, we estimate that the total annual hour burden per year for each broker-dealer subject to the demonstration requirement will be 71.0 hours.

2. Borrowing Requirements

We believe that temporary Rule 204T's borrow requirements for fail to deliver positions that are not closed out in accordance with the temporary rule will result in limited, if any, implementation costs to participants of a registered clearing agency, and broker-dealers from which they receive trades for clearance and settlement. These entities must already comply with the borrow requirements of Rule 203(b)(3)(iv) of Regulation SHO if a fail to deliver position has not been closed out in accordance with Regulation SHO's mandatory close-out requirement. Accordingly, these entities should already have in place the personnel, recordkeeping, systems, and surveillance mechanisms necessary to comply with the temporary rule's borrow requirements. Nevertheless, we recognize that each pre-borrow will impose costs on participants, broker-dealers, and investors and these costs can accumulate to significant amounts if the borrow requirement is imposed often.

The pre-borrow notification requirement of temporary Rule 204T(c) will impose costs on participants of a registered clearing agency. Temporary Rule 204T(c) requires a participant to notify any broker or dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,[143] (1) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of temporary Rule 204T(a), and (2) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.[144] This notification requirement may result in participants incurring costs related to

[143] See 17 CFR 203(b)(2)(iii) (providing for an exception from the "locate" requirement for market makers engaged in bona fide market making in that security at the time of the short sale).

[144] See temporary Rule 204T(c).

personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII, above, for purposes of the Paperwork Reduction Act, we estimate that it will take each participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to comply with the pre-borrow notification requirements of temporary Rule 204T(b). In addition, we estimate that the total annual hour burden per year for each participant subject to the notification requirement will be 2,016 hours.

Moreover, we believe any additional costs incurred in connection with the borrowing requirements of temporary Rule 204T(b) will be limited by the fact that if a participant becomes subject to the borrowing requirements of temporary Rule 204T(b), a broker-dealer that clears through the participant will not also be subject to the borrowing requirements of temporary Rule 204T(b) if the broker-dealer can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. This provision allows a broker-dealer to avoid the costs of being subject to the temporary rule's borrowing requirements, provided that the broker-dealer can demonstrate that it did not incur a fail to deliver position in the security on settlement date.

The certification requirement of temporary Rule 204T(b)(1) may impose some costs on broker-dealers having to demonstrate that it was not responsible for any part of the fail to deliver position of the participant. As discussed above, temporary Rule 204T(b)(1) requires the broker-dealer to timely certify to the participant that it has not incurred a fail to deliver position on settlement date in an equity security for which the participant has a fail to deliver position at a registered clearing agency or the broker-dealer is in compliance with the requirements set forth in the temporary rule's Pre-Fail Credit provision. This certification requirement may result in broker-dealers incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII, above, for purposes of the

Paperwork Reduction Act, we estimate that it will take each broker-dealer no more than approximately 0.16 hours (10 minutes) to comply with the certification requirement of temporary Rule 204T(b)(1). In addition, we estimate that the total annual hour burden per year for each broker-dealer subject to the certification requirement will be 71.0 hours.

Any potential additional costs associated with the temporary borrowing requirements will be limited by the fact that the temporary rule's borrowing requirements will not apply to Market Makers, provided that the Market Maker can demonstrate that it does not have an open fail to deliver position at the time of any additional short sales. This allows Market Makers to facilitate customer orders in a fast moving market without possible delays and added costs associated with complying with the pre-borrow penalty provision of temporary Rule 204T(b).

The demonstration requirement of temporary Rule 204T(b)(2) may impose costs on Market Makers. This demonstration requirement may result in Market Makers incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. For example, as discussed in detail in Section VII, above, for purposes of the Paperwork Reduction Act, we estimate that it will take each Market Maker no more than approximately 0.16 hours (10 minutes) to comply with the demonstration requirement of temporary Rule 204T(b)(2). In addition, we estimate that the total annual hour burden per year for each Market Maker subject to this demonstration requirement will be 604.8 hours.

3. Sales of Securities Pursuant to Rule 144

Consistent with our statements in connection with our recent amendments to Regulation SHO in connection with closing out fails to deliver in threshold securities sold pursuant to Rule 144,[145] we do not believe the temporary rule's close-out requirement will impose any significant

[145] See 2007 Regulation SHO Final Amendments, 72 FR at 45550-45551.

burden or cost on market participants. We believe that a close-out requirement of thirty-five consecutive settlement days from settlement date for fails to deliver resulting from sales of equity securities sold pursuant to Rule 144 will reduce costs by allowing participants of a registered clearing agency with a fail to deliver position additional time for delivery of these securities.

Participants may incur, however, some added costs for minor changes to their current systems to reflect the application of the temporary rule's close-out requirement to fails to deliver resulting from sales of all equity securities, rather than just threshold securities, sold pursuant to Rule 144 of the Securities Act.

D. Request for Comment

The Commission is sensitive to the costs and benefits of the temporary rule, and encourages commenters to discuss any additional costs or benefits beyond those discussed herein, as well as any reduction in costs. Commenters should provide analysis and data to support their views of the costs and benefits associated with the temporary rule.

- What, if any, additional benefits are involved in complying with the temporary rule? Should the temporary rule be modified in any way to increase the benefits of the temporary rule? If so, how?
- What, if any, additional costs are involved in complying with the temporary rule? What are the types of costs, and what are the amounts? Should the temporary rule be modified in any way to mitigate costs? If so, how?
- The temporary rule requires that participants of a registered clearing agency deliver securities by settlement date, or if the participants have not delivered shares by settlement date, borrow or purchase securities to close out the fail to deliver position by no later than

the beginning of regular trading hours on the settlement day following the day the participant incurred the fail to deliver position. What are the costs and benefits associated with purchasing versus borrowing securities to close out a fail to deliver position?

- What impact will the temporary rule have on borrowing costs? Please explain. What effect will the temporary rule have on the availability of equity securities for lending and borrowing?
- The temporary rule will allow a participant that has a fail to deliver position at a registered clearing agency in an equity security and can demonstrate that such fail to deliver position resulted from a long sale, two additional settlement days in which to close out that fail to deliver position by purchasing securities of like kind and quantity. What costs and benefits are associated with the long sale documentation requirement? Are there any operational or compliance concerns associated with this provision of the temporary rule?
- The temporary rule will allow a participant of a registered clearing agency two additional settlement days to close out any fail to deliver positions attributable to a Market Maker. What are the costs and benefits of allowing this additional time to close-out fails to deliver attributable to Market Makers? Are there any operational or compliance concerns associated with this provision of the temporary rule?
- Will the temporary rule create any additional implementation or operational costs associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modifications?

- To comply with the temporary rule, will broker-dealers be required to purchase new systems or implement changes to existing systems? Will changes to existing systems be significant? What are the costs and benefits associated with acquiring new systems or making changes to existing systems? What, if any, changes will need to be made to existing records? What are the costs and benefits associated with any changes?
- Will there be any increases in staffing and associated overhead costs? What are the costs and benefits associated with hiring new staff or retraining existing staff? Will other resources need to be re-dedicated to comply with the temporary rule?
- How much, if any, will the temporary rule affect compliance costs for small, medium, and large broker-dealers (e.g., personnel or system changes)? We seek comment on the costs of compliance that may arise.
- We solicit comment on whether the costs will be incurred on a one-time or ongoing basis, as well as cost estimates. In addition, we seek comment as to whether the temporary rule will decrease any costs for any market participants. We seek comment about any other costs and cost reductions associated with the temporary rule.
- We recognize that the temporary rule may increase the costs of legitimate short selling and lessen some of the benefits of legitimate short selling, which, in turn, could result in a reduction of short selling. To what extent, if any, will the temporary rule impact legitimate short selling and market efficiency?
- The temporary rule does not allow any exceptions for fails to deliver due to mechanical aspects of corporate events, such as equity offers, including initial public offerings, and tender offers. Will the temporary rule cause any disruption to these corporate events? Can the costs of any disruption be quantified?

- What, if any, additional costs are involved in complying with the borrowing requirements under temporary Rule 204T(b)? What are the types of costs, and what are the amounts? Should the temporary rule be modified in any way to mitigate costs? If so, how? Are there any operational or compliance concerns associated with the borrowing requirements under temporary Rule 204T(b)?
- The temporary rule will allow a broker-dealer that clears through a participant that becomes subject to the borrowing requirements of temporary Rule 204T(b) to avoid being subject to the temporary rule's borrowing requirements if the broker-dealer can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. What costs and benefits are associated with the certification requirement? Are there any operational or compliance concerns associated with this provision of the temporary rule?
- Temporary Rule 204T(c) imposes a pre-borrow notification requirement on participants. Will such a notification requirement impose operational or systems costs on participants? What types of communication mechanisms do participants use to comply with this requirement of the temporary rule? What are the costs and benefits of this notification requirement?
- What, if any, additional costs are associated with extending the close-out requirement for Rule 144 securities? What are the types of costs, and what are the amounts? Who bears these costs? Should the exception be modified in any way to mitigate costs? If so, how?
- Please identify any other costs, including reductions in costs, associated with sales of Rule 144 restricted securities not already discussed.

IX. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and whenever it is required to consider or determine if an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.[146] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition.[147] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe the temporary rule will have minimal impact on the promotion of efficiency. The temporary rule is intended to further reduce fails to deliver and address abusive "naked" short selling in equity securities by requiring that participants of a registered clearing agency deliver securities by settlement date, or if the participants have not delivered shares by settlement date, the participants must, by no later than the beginning of regular trading hours on the Close-Out Date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity. A participant that does not comply with this close-out requirement, and any broker-dealer from which it receives trades for clearance and settlement, will not be able to short sell the security either for itself or for the account of another, unless it has first arranged to borrow the security, until the fail to deliver position is closed out.

146 15 U.S.C. 78c(f).

147 15 U.S.C. 78w(a)(2).

The temporary rule is designed to ensure that buyers of equity securities receive delivery of their shares, thereby helping to reduce persistent fails to deliver, which may have a negative effect on the securities markets and investors and also may be used to facilitate some manipulative strategies. By requiring that participants of a registered clearing agency deliver securities by settlement date and to the extent that participants have not delivered shares by settlement date, borrow or purchase securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the Close-Out Date, the temporary rule will promote the prompt clearance and settlement of securities transactions. By doing so, the temporary rule will further our goals of helping to eliminate any possibility that abusive "naked" short selling, as well as persistent fails to deliver, will contribute to the disruption of markets in equity securities and, thereby, will help ensure that investors remain confident that trading can be conducted without the illegal influence of manipulation. A loss of confidence in the market for these securities can lead to panic selling, which may be further exacerbated by potentially abusive "naked" short selling. As a result, prices of these securities may artificially and unnecessarily decline below the price level that would have resulted from the normal price discovery process, threatening the disruption of the markets for these securities. We seek comment regarding whether the temporary rule may adversely impact liquidity, disrupt markets, or unnecessarily increase risks or costs to participants of a registered clearing agency.

In addition, we believe that the temporary rule will have minimal impact on the promotion of capital formation. Issuers and investors have repeatedly expressed concerns about fails to deliver in connection with manipulative "naked" short selling.[148] The perception that abusive "naked" short selling is occurring in securities could undermine the confidence of

[148] See, e.g., 2008 Regulation SHO Final Amendments, supra note 19.

investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.[149] To the extent that "naked" short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the temporary rule will improve investor confidence about the security. In addition, the temporary rule may lead to a greater certainty in the settlement of these securities which should strengthen investor confidence in the settlement process

We also believe that the temporary rule will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. By requiring that participants of a registered clearing agency deliver securities by settlement date, and to the extent that participants have not delivered shares by settlement date, borrow or purchase securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the Close-Out Date, we believe the temporary rule will promote competition by requiring similarly situated participants of a registered clearing agency, including broker-dealers from which they receive trades for clearance and settlement, to close out fail to deliver positions in any equity securities within similar time-frames. Moreover, the requirements of the temporary rule will help to eliminate any possibility that abusive "naked" short selling may contribute to the disruption of markets in equity securities and, therefore, will help ensure that all investors remain confident that trading in these securities can be conducted without the influence of illegal manipulation. We also believe that the temporary rule will promote competition by protecting and enhancing the operation, integrity, and stability of the markets. At the same time, the

[149] In connection with prior proposed amendments to Regulation SHO aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling, such as the 2007 Regulation SHO Proposed Amendments, we sought comment on whether such proposed amendments would promote capital formation, including whether the proposed increased short sale restrictions would affect investors' decisions to invest in certain equity securities. In response, commenters expressed concern about the potential impact of "naked" short selling on capital formation claiming that "naked" short selling causes a drop in an issuer's stock price that may limit the issuer's ability to access the capital markets. See, e.g., letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007; letter from NCANS.

temporary rule will help to maintain fair and orderly markets without unduly restricting legitimate short selling.

In addition, by providing a close-out requirement of 35 consecutive settlement days from settlement date for fails to deliver resulting from sales of equity securities sold pursuant to Rule 144 of the Securities Act, we believe the temporary rule will promote competition by requiring similarly situated participants to close out fail to deliver positions in any equity securities resulting from sales of Rule 144 securities within the same time-frame.

Similarly, an extended close-out requirement for fails to deliver resulting from long sales that are attributable to a Market Maker, will promote competition by requiring similarly situated participants to close out these fail to deliver positions within the same time-frame.

We request comment on whether the temporary rule is likely to promote efficiency, capital formation, and competition.

X. Final Regulatory Flexibility Analysis

The Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with 5 U.S.C. 604. This FRFA relates to the amendments that add temporary Rule 204T to Regulation SHO, which we are adopting in this release.[150]

A. Need for and Objectives of the Rule

Sections I through VI of this release describe the reasons for and objectives of temporary Rule 204T. As we discuss in detail above, we have become concerned that there is a substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets.

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[150] Although the requirements of the Regulatory Flexibility Act are not applicable to rules adopted under the Administrative Procedure Act's "good cause" exception, see 5 U.S.C. 601(2) (defining "rule" and notice requirements under the Administrative Procedures Act), we nevertheless prepared a FRFA.

B. Small Entities Affected by the Rule

The entities covered by the temporary rule will include small entities that are participants of a registered clearing agency and small broker-dealers from which participants receive trades for clearance and settlement. In addition, the entities covered by the temporary rule will include small entities that are market participants that effect sales subject to the requirements of Regulation SHO. Although it is impossible to quantify every type of small entity covered by the temporary rule, Paragraph (c)(1) of Rule 0-10 under the Exchange Act[151] 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. We estimate that as of 2007 there were approximately 896 broker-dealers that qualified as small entities as defined above.[152]

As noted above, the entities covered by the temporary rule will include small entities that are participants of a registered clearing agency. As of July 31, 2008, approximately 91% of participants of the NSCC, the primary registered clearing agency responsible for clearing U.S. transactions, were registered as broker-dealers. Participants not registered as broker-dealers include such entities as banks, U.S.-registered exchanges, and clearing agencies. Although these entities are participants of a registered clearing agency, generally these entities do not engage in the types of activities that would implicate the close-out requirements of Regulation SHO. Such activities of these entities include creating and redeeming Exchange Traded Funds, trading in

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151 17 CFR 240.0-10(c)(1).

152 These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

municipal securities, and using NSCC's Envelope Settlement Service or Inter-city Envelope Settlement Service. These activities rarely lead to fails to deliver and, if fails to deliver do occur, they are small in number and are usually cleaned up within a day. Thus, such fails to deliver would not trigger the close-out provisions of Regulation SHO.

The federal securities laws do not define what is a "small business" or "small organization" when referring to a bank. The Small Business Administration regulations define "small entities" to include banks and savings associations with total assets of $165 million or less.[153] As of July 31, 2008, no bank that was a participant of the NSCC was a small entity because none met these criteria.

Paragraph (e) of Rule 0-10 under the Exchange Act[154] states that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (1) has been exempted from the reporting requirements of Rule 11Aa3-1 under the Exchange Act; and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0-10. No U.S. registered exchange is a small entity because none meets these criteria.

Paragraph (d) of Rule 0-10 under the Exchange Act[155] states that the term "small business" or "small organization," when referring to a clearing agency, means a clearing agency that: (1) compared, cleared and settled less than $500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter); (2) had less than $200 million in funds and securities in its custody or control at all times during the preceding

153 See 13 CFR 121.201.

154 17 CFR 240.0-10(e).

155 17 CFR 240.0-10(d).

fiscal year (or in the time that it has been in business, if shorter); and (3) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined by Rule 0-10. No clearing agency that is subject to the requirements of Regulation SHO is a small entity because none meets these criteria.

C. Projected Reporting, Recordkeeping and Other Compliance Requirements

The temporary rule may impose some new or additional reporting, recordkeeping, or compliance costs on small entities that are participants of a clearing agency registered with the Commission and small broker-dealers from which the participant receives trades for clearance and settlement. We do not believe, at this time, that any specialized professional skills will be necessary to comply with the temporary rule.

D. Agency Action to Minimize Effect on Small Entities

As required by the Regulatory Flexibility Act, we have considered alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. Temporary Rule 204T should not adversely affect small entities because it imposes minimal new reporting, record keeping, or compliance requirements. Moreover, it is not appropriate to develop separate requirements for small entities because we think all small entities that are broker-dealers, should be subject to the enhanced delivery requirements imposed by the temporary rule.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with temporary Rule 204T. The Commission has designed the temporary rule so that it is consistent with the close-out requirements of Rule 203(b)(3) of Regulation SHO.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[156] In connection with the temporary rule, we considered the following alternatives: (1) Establishing different compliance or reporting standards or timetable that take into account the resources available to small entities; (2) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (3) using performance rather than design standards; and (4) exempting small entities from coverage of the rule, or any part of the rule.

The temporary rule furthers the Commission's stated goal of helping to eliminate any possibility that abusive "naked" short selling may contribute to the substantial disruption in the securities markets and, therefore, to help ensure that investors remain confident that trading in equity securities can be conducted without the illegal influence of manipulation. The temporary rule also furthers the goals of helping to maintain fair and orderly markets against the threat of sudden and excessive fluctuations of securities prices generally and disruption in the functioning of the securities markets.

The temporary rule should not adversely affect small entities because the rule may impose only minimal new compliance requirements. Moreover, it is not appropriate to develop different compliance requirements for small entities with respect to the temporary rule because we think all entities, including small entities, should be subject to the requirements of the temporary rule. We believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the Commission's goal of addressing abusive "naked" short selling. We have

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[156] See 5 U.S.C. 603(c).

concluded similarly that it is not consistent with the goal of the temporary rule to further clarify, consolidate or simplify the temporary rule for small entities. The Commission also believes that it is inconsistent with the purposes of the Exchange Act to use performance standards to specify different requirements for small entities or to exempt small entities from having to comply with the temporary rule.

G. General Request for Comments

We solicit written comments regarding our analysis. We request comment on whether the temporary rule will have any effects that we have not discussed. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

XI. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 17A, 19 and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78f, 78i(h), 78j, 78k-1, 78o, 78o-3, 78q, 78q-1, 78s and 78w(a), the Commission is adopting, as an interim final temporary rule, Rule 204T, amendments to Regulation SHO.

XII. Text of the Amendments to Regulation SHO

List of Subjects

17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, Part 242, of the Code of Federal Regulations is amended as follows.

PART 242 — REGULATIONS M, SHO, ATS, AC, AND NMS, AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

1. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

2. Section 242.204T is added to read as follows:

§ 242.204T Short sales.

(a) A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity; Provided, however:

(1) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security and the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing securities of like kind and quantity;

(2) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security sold pursuant to § 230.144 of this chapter for thirty-five consecutive settlement days after the settlement date for a sale in that equity security, the participant shall, by no later than the beginning of regular trading hours on the thirty-sixth

consecutive settlement day following the settlement date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity; or

(3) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security that is attributable to bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market (individually a "Market Maker," collectively "Market Makers"), the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.

(b) If a participant of a registered clearing agency has a fail to deliver position in any equity security at a registered clearing agency and does not close out such fail to deliver position in accordance with the requirements of paragraph (a) of this section, the participant and any broker or dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in § 242.203(b)(2)(iii), may not accept a short sale order in the equity security from another person, or effect a short sale in the equity security for its own account, to the extent that the broker or dealer submits its short sales to that participant for clearance and settlement, without first borrowing the security, or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency; Provided, however:

(1) A broker or dealer shall not be subject to the requirements of paragraph (b) of this section if the broker or dealer timely certifies to the participant of a registered clearing agency that it has not incurred a fail to deliver position on settlement date for a long or short sale in an

equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with paragraph (e) of this section.

(2) The requirements of paragraph (b) of this section shall not apply to Market Makers provided the Market Maker can demonstrate that it does not have an open short position in the equity security at the time of any additional short sales.

(c) The participant must notify any broker or dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in § 242.203(b)(2)(iii):

(1) That the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of paragraph (a) of this section; and

(2) When the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.

(d) If a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or from which it receives trades for settlement, based on such broker's or dealer's short position, the provisions of paragraphs (a) and (b) of this section relating to such fail to deliver position shall apply to such registered broker or dealer that was allocated the fail to deliver position, and not to the participant. A broker or dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of paragraph (a) of this section must immediately notify the participant that it has become subject to the requirements of paragraph (b) of this section.

(e) Even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with paragraph (a) of this section, or has not allocated a fail to deliver position to a broker or dealer in accordance with paragraph (d) of this section, a broker or dealer shall not be subject to the requirements of paragraph (a) or (b) of this section if the broker or dealer purchases securities prior to the beginning of regular trading hours on the settlement day after the settlement date for a long or short sale to close out an open short position, and if:

(1) The purchase is bona fide;

(2) The purchase is executed on, or after, trade date but by no later than the end of regular trading hours on settlement date for the transaction;

(3) The purchase is of a quantity of securities sufficient to cover the entire amount of the open short position; and

(4) The broker or dealer can demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker or dealer is seeking to demonstrate that it has purchased shares to close out its open short position.

(f) Definitions. (1) For purposes of this section, the term settlement date shall mean the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security.

(2) For purposes of this section, the term regular trading hours has the same meaning as in Rule 600(b)(64) of Regulation NMS (17 CFR 242.600(b)(64)).

(g) This temporary section will expire and no longer be effective on July 31, 2009.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 14, 2008

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 241 AND 242

[Release No. 34-58775; File No. S7-19-07]

RIN 3235-AJ57

Amendments to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to Regulation SHO under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments are intended to further reduce the number of persistent fails to deliver in certain equity securities by eliminating the options market maker exception to the close-out requirement of Regulation SHO. As a result of the amendments, fails to deliver in threshold securities that result from hedging activities by options market makers will no longer be excepted from Regulation SHO's close-out requirement. The Commission is also providing guidance regarding bona fide market making activities for purposes of the market maker exception to Regulation SHO's locate requirement.

EFFECTIVE DATE: October 17, 2008.

FOR FURTHER INFORMATION CONTACT: James A. Brigagliano, Associate Director, Josephine J. Tao, Assistant Director, Victoria L. Crane, Branch Chief, Joan M. Collopy, Special Counsel, Christina M. Adams and Matthew Sparkes, Staff Attorneys, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION: The Commission is amending Rule 203 of Regulation SHO [17 CFR 242.203] under the Exchange Act.

I. Introduction

To further Regulation SHO's goal of reducing fails to deliver in equity securities, the Commission is adopting its proposal[1] to eliminate the options market maker exception to the close-out requirement of Regulation SHO.[2] As discussed in detail below, we believe that eliminating the exception, and thereby imposing additional delivery requirements on securities with a substantial amount of fails to deliver, will help to protect and enhance the operation, integrity, and stability of the markets, as well as reduce potential short selling abuses.

II. Background

A. Regulation SHO

Regulation SHO, which became fully effective on January 3, 2005, sets forth the regulatory framework governing short sales.[3] Among other things, Regulation SHO imposes a close-out requirement to address failures to deliver stock on trade settlement date[4] and to target

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1 See Exchange Act Release No. 56213 (Aug. 7, 2007), 72 FR 45558 (Aug. 14, 2007) ("Reproposal"); see also Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006) ("2006 Regulation SHO Proposed Amendments"); Exchange Act Release No. 58107 (July 7, 2008), 73 FR 40201 (July 14, 2008) ("2008 Regulation SHO Re-Opening Release").

2 17 CFR 242.200; see also Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release").

3 Rule 200(a) of Regulation SHO defines a short sale as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." 17 CFR 242.200(a).

4 Generally, investors complete or settle their security transactions within three business days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three business days after the trade is executed. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnership interests that trade on an exchange. Government securities and stock options settle on the next business day following the trade. In addition, Rule 15c6-1 prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. 17

potentially abusive "naked" short selling[5] in certain equity securities.[6] While the majority of trades settle on time,[7] Regulation SHO is intended to address those situations where the level of fails to deliver for the particular stock is so substantial that it might impact the market for that security.[8]

Although high fails levels exist only for a small percentage of issuers,[9] we believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the

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CFR 240.15c6-1; Exchange Act Release No. 33023 (Oct. 7, 1993), 58 FR 52891 (Oct. 13, 1993). However, failure to deliver securities on T+3 does not violate Rule 15c6-1.

5 We have previously noted that abusive "naked" short selling, while not defined in the federal securities laws generally refers to selling short without having stock available for delivery and intentionally failing to deliver stock within the standard three day settlement cycle. See 2004 Regulation SHO Adopting Release, 69 FR at 48009, n.10; Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR at 45544, n.3 (Aug. 14, 2007) ("2007 Regulation SHO Final Amendments"); Exchange Act Release No. 57511 (March 17, 2008), 73 FR 15376 (March 21, 2008) ("Naked Short Selling Anti-Fraud Rule Proposing Release").

6 In 2003, the Commission settled a case against certain parties relating to allegations of manipulative short selling in the stock of Sedona Corporation. The Commission alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with Sedona stock, and depressed its price. See Rhino Advisors, Inc. and Thomas Badian, Lit. Rel. No. 18003 (Feb. 27, 2003); see also, SEC v. Rhino Advisors, Inc. and Thomas Badian, Civ. Action No. 03 civ 1310 (RO) (S.D.N.Y); see also, Securities Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) ("2003 Regulation SHO Proposing Release") (describing the alleged activity in the case involving stock of Sedona Corporation); 2004 Regulation SHO Adopting Release, 69 FR at 48016, n.76.

7 According to the National Securities Clearing Corporation ("NSCC"), 99% (by dollar value) of all trades settle on time. Thus, on an average day, approximately 1% (by dollar value) of all trades, including equity, debt, and municipal securities fail to settle. The vast majority of these fails are closed out within five days after T+3.

8 These fails to deliver may arise from either short or long sales of securities. There may be legitimate reasons for a fail to deliver. For example, human or mechanical errors or processing delays can result from transferring securities in custodial or other form rather than book-entry form, thereby causing a fail to deliver on a long sale within the normal three-day settlement period. In addition, broker-dealers that make markets in a security ("market makers") and who sell short thinly-traded, illiquid stock in response to customer demand may encounter difficulty in obtaining securities when the time for delivery arrives. The Commission's Office of Economic Analysis ("OEA") estimates that, on an average day between May 1, 2007 and July 31, 2008 (i.e., the time period that includes all full months after the Commission started receiving price data from NSCC), trades in "threshold securities," as defined in Rule 203(b)(c)(6) of Regulation SHO, that fail to settle within T+3 account for approximately 0.3% of dollar value of trading in all equity securities.

9 The average daily number of securities on a threshold list (as defined infra note 22) in July 2008 was approximately 523 securities, which comprised 0.6% of all equity securities, including those that are not covered by Regulation SHO. Regulation SHO's close-out requirement applies to any equity security of an issuer that is registered under Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

respective buyer, and that all buyers of securities have a right to expect prompt delivery of securities purchased. In addition, as we have stated on several prior occasions, we are concerned about the negative effect that fails to deliver may have on the markets and shareholders.[10] For example, fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.[11] In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.[12]

Moreover, sellers that fail to deliver securities on settlement date may enjoy fewer restrictions than if they were required to deliver the securities in a timely manner, and such sellers may attempt to use this additional freedom to engage in trading activities that are designed to improperly depress the price of a security.[13] In addition, by not borrowing securities and, therefore, not making delivery within the standard three-day settlement period, the seller avoids the costs of borrowing.

In addition, issuers and investors have repeatedly expressed concerns about fails to deliver in connection with manipulative "naked" short selling. For example, in response to proposed amendments to Regulation SHO in 2006[14] designed to further reduce the number of persistent fails to deliver in certain equity securities by eliminating Regulation SHO's

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[10] See 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; Reproposal, 72 FR at 45558-45559; "Naked" Short Selling Anti-Fraud Rule Proposing Release, 73 FR at 15378.

[11] See id.

[12] See id.

[13] See Reproposal, 72 FR at 45559.

[14] See 2006 Regulation SHO Proposed Amendments, supra note 1.

"grandfather" provision, and limiting the duration of the rule's options market maker exception, the Commission received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[15] Commenters continued to express these concerns in response to the Reproposal.[16]

To the extent that fails to deliver might be part of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[17] such fails to deliver may undermine the confidence of investors.[18] These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.[19] In addition, issuers

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15 See, e.g., letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Sept. 11, 2006; letter from Daniel Behrendt, Chief Financial Officer, and Douglas Klint, General Counsel, TASER International, dated Sept. 18, 2006; letter from John Royce, dated April 30, 2007; letter from Michael Read, dated April 29, 2007; letter from Robert DeVivo, dated April 26, 2007 ("DeVivo"); letter from Ahmed Akhtar, dated April 26, 2007.

16 See, e.g., letter from Jack M. Wedam, dated Oct. 16, 2007; letter from Michael J. Ryan, Executive Director and Senior Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated Sept. 13, 2007 ("U.S. Chamber of Commerce"); letter from Robert W. Raybould, CEO Enteleke Capital Corp., dated Sept. 12, 2007 ("Raybould"); letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 11, 2007 ("NCANS").

17 See supra, note 6 (discussing a case in which we alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the company's stock, and depressed its price); see also S.E.C. v. Gardiner, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. March 27, 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price); U.S. v. Russo, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b–5).

18 In response to the Reproposal, we received comment letters discussing the impact of fails to deliver on investor confidence. See, e.g., letter from NCANS. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 30, 2006 ("NCANS 2006"); letter from Richard Blumenthal, Attorney General, State of Connecticut, dated Sept. 19, 2006 ("Blumenthal").

19 In response to the Reproposal, we received comment letters expressing concern about the impact of potential "naked" short selling on capital formation, claiming that "naked" short selling causes a drop in an issuer's stock price and may limit the issuer's ability to access the capital markets. See, e.g., letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007 ("Medis"); letter from NCANS. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Congressman Tom Feeney - Florida, U.S. House of Representatives, dated Sept. 25, 2006 ("Feeney"); see also letter from Zix Corporation, dated Sept. 19, 2006 ("Zix") (stating that "[m]any investors attribute the Company's frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company "do something" about the perceived manipulative short selling. This perception that manipulative short selling of the Company's securities is continually occurring has undermined

may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[20] Unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[21]

B. Amendments to Regulation SHO's Close-Out Requirement

Regulation SHO's close-out requirement, which is contained in Rule 203(b)(3) of Regulation SHO, applies only to securities in which a substantial amount of fails to deliver have occurred (also known as "threshold securities").[22] Specifically, the close-out requirement requires a participant of a clearing agency registered with the Commission[23] to take immediate

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the confidence of many of the Company's investors in the integrity of the market for the Company's securities.").

[20] Due in part to such concerns, some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company ("DTC") or broker-dealers. See Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, at 62975 (Nov. 6, 2003). Some issuers have attempted to withdraw their issued securities on deposit at DTC, which makes the securities ineligible for book-entry transfer at a securities depository. See id. Withdrawing securities from DTC or requiring custody-only transfers would undermine the goal of a national clearance and settlement system that is designed to reduce the physical movement of certificates in the trading markets. See id. We note, however, that in 2003 the Commission approved a DTC rule change clarifying that its rules provide that only its participants may withdraw securities from their accounts at DTC, and establishing a procedure to process issuer withdrawal requests. See Securities Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037 (June 11, 2003).

[21] See 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Final Amendments, 72 FR at 45544; Reproposal, 72 FR at 45558-45559; "Naked" Short Selling Anti-Fraud Rule Proposing Release, 73 FR at 15378 (providing additional discussion of the impact of fails to deliver on the market); see also 2003 Regulation SHO Proposing Release, 68 FR at 62975 (discussing the impact of "naked" short selling on the market).

[22] A threshold security is defined in Rule 203(c)(6) as any equity security of an issuer that is registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act (15 U.S.C. 78o(d)): (i) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding; and (ii) that is included on a list ("threshold securities list") disseminated to its members by a self-regulatory organization ("SRO"). See 17 CFR 242.203(c)(6). Currently, each SRO provides the threshold securities list for those securities for which the SRO is the primary market.

[23] For purposes of Regulation SHO, the term "participant" has the same meaning as in section 3(a)(24) of the Exchange Act. See 15 U.S.C. 78c(a)(24). The term "registered clearing agency" means a clearing agency, as defined in section 3(a)(23) of the Exchange Act, that is registered as such pursuant to section 17A of the Exchange Act. See 15 U.S.C. 78c(a)(23)(A), 78q-1 and 15 U.S.C. 78q-1(b), respectively. See also 2004 Regulation SHO Adopting Release, 69 FR at 48031. As of July 31, 2008 approximately 91% of participants of

action to close out a fail to deliver position in a threshold security in the Continuous Net Settlement ("CNS")[24] system that has persisted for 13 consecutive settlement days by purchasing securities of like kind and quantity.[25] In addition, if the failure to deliver has persisted for 13 consecutive settlement days, Rule 203(b)(3)(iv) prohibits the participant, and any broker-dealer for which it clears transactions, including market makers, from accepting any short sale orders or effecting further short sales in the particular threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity.[26]

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the NSCC, the primary registered clearing agency responsible for clearing U.S. transactions, were registered as broker-dealers. Those participants not registered as broker-dealers include such entities as banks, U.S.-registered exchanges, and clearing agencies. Although these entities are participants of a registered clearing agency, generally these entities do not engage in the types of activities that would implicate the close-out requirements of Regulation SHO. Such activities of these entities include creating and redeeming Exchange Traded Funds, trading in municipal securities, and using NSCC's Envelope Settlement Service or Inter-city Envelope Settlement Service. These activities rarely lead to fails to deliver and, if fails to deliver do occur, they are small in number and are usually closed out within a day. Thus, such fails to deliver would not trigger the close-out provisions of Regulation SHO.

[24] The majority of equity trades in the United States are cleared and settled through systems administered by clearing agencies registered with the Commission. The NSCC clears and settles the majority of equity securities trades conducted on the exchanges and over the counter. NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of their securities delivery and payment obligations daily. In addition, NSCC guarantees the completion of all transactions and interposes itself as the contraparty to both sides of the transaction. While NSCC's rules do not authorize it to require member firms to close out or otherwise resolve fails to deliver, NSCC reports to the SROs those securities with fails to deliver of 10,000 shares or more. The SROs use NSCC fails data to determine which securities are threshold securities for purposes of Regulation SHO.

[25] 17 CFR 242.203(b)(3).

[26] Id. at (b)(3)(iv). It is possible under Regulation SHO that a close out by a participant of a registered clearing agency may result in a fail to deliver position at another participant if the counterparty from which the participant purchases securities fails to deliver. However, Regulation SHO prohibits a participant of a registered clearing agency, or a broker-dealer for which it clears transactions, from engaging in "sham close outs" by entering into an arrangement with a counterparty to purchase securities for purposes of closing out a fail to deliver position and the purchaser knows or has reason to know that the counterparty will not deliver the securities, and which thus creates another fail to deliver position. See id. at (b)(3)(vii); 2004 Regulation SHO Adopting Release, 69 FR at 48018 n.96. In addition, we note that borrowing securities, or otherwise entering into an arrangement with another person to create the appearance of a purchase would not satisfy the close-out requirement of Regulation SHO. For example, the purchase of paired positions of stock and options that are designed to create the appearance of a bona fide purchase of securities but that are nothing more than a temporary stock lending arrangement would not satisfy Regulation SHO's close-out requirement.

As adopted in August 2004, Rule 203(b)(3) of Regulation SHO included two exceptions to the mandatory close-out requirement. The first was the "grandfather" provision, which excepted fails to deliver established prior to a security becoming a threshold security.[27] The second was the "options market maker exception," which excepted any fail to deliver in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security.[28]

At the time of Regulation SHO's adoption, the Commission stated that it would monitor the operation of Regulation SHO to determine whether grandfathered fail to deliver positions were being cleared up under the existing delivery and settlement guidelines or whether any further regulatory action with respect to the close out provisions of Regulation SHO was warranted.[29] In addition, with respect to the options market maker exception, the Commission noted that it would take into consideration any indications that this provision was operating significantly differently from the Commission's original expectations.[30]

Based, in part, on the results of examinations conducted by the Commission's staff and the SROs since Regulation SHO's adoption, as well as the persistence of certain securities on threshold securities lists, on July 14, 2006, the Commission proposed amendments to Regulation

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[27] See 2004 Regulation SHO Adopting Release, 69 FR at 48031. The "grandfathered" status applied in two situations: (i) to fail to deliver positions occurring before January 3, 2005, Regulation SHO's effective date; and (ii) to fail to deliver positions that were established on or after January 3, 2005 but prior to the security appearing on a threshold securities list.

[28] See 2004 Regulation SHO Adopting Release, 69 FR at 48031.

[29] See id. at 48018.

[30] See id. at 48019.

SHO,[31] which were intended to reduce the number of persistent fails to deliver in certain equity securities by eliminating the "grandfather" provision and narrowing the options market maker exception contained in that rule. In addition, in March 2007, the Commission re-opened the comment period to the 2006 Regulation SHO Proposed Amendments for thirty days to provide the public with an opportunity to comment on a summary of the National Association of Securities Dealers, Inc.'s ("NASD's") (n/k/a Financial Industry Regulatory Authority, Inc.) analysis that the NASD had submitted to the public file on March 12, 2007. In addition, the notice regarding the re-opening of the comment period directed the public's attention to summaries of data collected by the Commission's Office of Compliance Inspections and Examinations and the New York Stock Exchange LLC ("NYSE").[32]

On June 13, 2007, we approved the adoption of the amendment, as proposed, to eliminate the "grandfather" provision of Regulation SHO.[33] With respect to the options market maker exception, however, in response to comments to the 2006 Regulation SHO Proposed Amendments, we reproposed amendments to eliminate the exception.[34] In addition, the Commission sought comment on two alternative proposals that would require options market maker fails to deliver to be closed out within specific time-frames.[35] The Reproposal also included an amendment to Regulation SHO that would require brokers-dealers marking a sale as "long" to document the present location of the securities being sold.

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31 See 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

32 See Securities Exchange Act Release No. 55520 (March 26, 2007), 72 FR 15079 (March 30, 2007) ("2007 Regulation SHO Re-Opening Release").

33 See 2007 Regulation SHO Final Amendments, 72 FR 45544.

34 See Reproposal,. 72 FR 45558.

35 See id.

We received over 1000 comment letters in response to the Reproposal.[36] Some commenters urged the Commission to obtain empirical data to demonstrate the relationship between fails to deliver and the options market maker exception before determining whether additional rulemaking was necessary.[37] In particular, commenters urged the Commission to obtain data relating to the impact of the elimination of the "grandfather" provision and connecting fails to deliver to the options market maker exception.[38] In response, the Commission staff obtained data from SROs, options market makers, and clearing agency participants that shows extensive use of the options market maker exception to Regulation SHO's close-out requirement and the resulting fails to deliver that were not closed out during 2006, 2007, and 2008. In addition, OEA provided data which indicates that since the elimination of the "grandfather" provision, fails to deliver in threshold securities with options traded on them ("optionable threshold securities") have increased significantly. The Commission made this data available to the public for review and comment by including it in a Commission release and re-opening the comment period to the Reproposal on July 7, 2008.[39] The comment period ended on August 13, 2008.

As discussed below, after considering the comments received, the data, and the purposes underlying Regulation SHO, we are adopting amendments to eliminate the options market maker

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36 The comment letters are available on the Commission's Internet Web Site at http://www.sec.gov/comments/s7-19-07/s71907.shtml.

37 See, e.g., Comments of Keith F. Higgins, Committee on Federal Regulation of Securities, American Bar Association, Section of Business Law, dated Oct. 5, 2007 ("ABA"); comments of John Gilmartin and Ben Londergan, Group One Trading, LP, dated Sept. 28, 2007; see also comments of Gerald D. O'Connell, Susquehanna Investment Group, dated Oct. 11, 2007 ("Susquehanna").

38 See letter from ABA.

39 See 2008 Regulation SHO Re-Opening Release, 73 FR 40201.

exception, as proposed.[40] At this time, we are not acting on the proposed amendments to Rule 200(g) of Regulation SHO regarding long sale documentation. Instead, in a companion release we have adopted a "naked" short selling anti-fraud rule that, in part, targets seller's representations regarding long sales.[41] In addition, we note that we have adopted an interim final temporary rule, Rule 204T, which strengthens the delivery requirements for sales of all equity securities.[42] Under temporary Rule 204T, fail to deliver positions resulting from short sales of all equity securities by options market makers must be closed out by no later than the beginning of regular trading hours on the settlement day after the fail to deliver position occurs.[43] In conjunction with these short sale-related initiatives, and our goal of further reducing fails to deliver and addressing potentially abusive "naked" short selling, we believe that we must eliminate Regulation SHO's options market maker exception.

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40 On September 17, 2008, we issued an emergency order pursuant to Section 12(k)(2) of the Exchange Act in which we adopted and made immediately effective the elimination of the options market maker exception to Regulation SHO's close-out requirement. See Exchange Act Release No. 58572 (Sept. 17, 2008) (the "September Emergency Order"). The September Emergency Order expires on October 17, 2008. This release makes permanent the amendments to Rule 203(b)(3) of Regulation SHO contained in the September Emergency Order.

41 See Exchange Act Release No. 58774 (Oct. 14, 2008); see also, September Emergency Order, supra note 40 (adopting and making immediately effective Rule 10b-21, a "naked" short selling anti-fraud rule).

42 See Exchange Act Release No. 58773 (Oct. 14, 2008) ("Interim Final Temporary Rule"); see also, September Emergency Order, supra note 40 (adding to Regulation SHO, and making immediately effective, temporary Rule 204T, imposing enhanced delivery requirements for sales of all equity securities).

43 See id. The Interim Final Temporary Rule includes a limited exception from its delivery requirements for registered market makers, options market makers, or other market makers obligated to quote in the over-the-counter market. Specifically, temporary Rule 204T(a)(3) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security that is attributable to bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.

III. Options Market Maker Exception

A. Discussion of Comments to the Reproposal and 2008 Regulation SHO Re-Opening Release

The Commission received comment letters from numerous entities, including issuers, individual retail investors, options market makers, SROs, elected officials, and academics.[44] Although the comment letters are publicly available to be read in their entirety, we highlight below some of the main issues, concerns, and suggestions raised in the letters.

Several commenters supported the proposal to eliminate the options market maker exception. One commenter stated that it believes that the current options market maker exception "harms investors and issuers, hinders the formation of capital, and is fatally flawed as written" and that it should be eliminated.[45] Another commenter stated that the options market maker exception "is a well known tool of manipulators and must be removed to ensure a level playing field for public companies and their shareholders."[46] One commenter that supported the amendments noted that "options market makers should factor the cost of borrowing stock and

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44 See, e.g., letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Oct. 1, 2007 ("Overstock"); letter from NCANS; letter from James H. Bramble, Vice President & General Counsel, USANA Health Sciences, Inc., dated Aug. 31, 2007 ("USANA"); letter from Paul Rivett, Vice President and Chief Legal Officer, Fairfax Financial Holdings, Ltd., dated Sept. 12, 2007 ("Fairfax Financial"); letter from Medis; letter from U.S. Chamber of Commerce; letter from Thomas Vallarino, dated Sept. 17, 2007; letter from Mark L. Shurtleff, Attorney General, State of Utah, dated Sept. 13, 2007; James J. Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University, dated Sept. 10, 2007 ("Angel"); letter from Ira D. Hammerman, Senior Vice President and General Counsel, SIFMA, dated Sept. 26, 2007 ("SIFMA"); letter from ABA; letter from Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange, dated Sept. 17, 2007 ("CBOE"); letter from Gerard S. Citera, Chadbourne & Parke LLP, dated Sept. 13, 2007 ("UBS"); letter from Charles Mogilevsky, Managing Director, Citigroup Derivatives Markets, Inc., dated Sept. 14, 2007 ("Citigroup"); letter from The American Stock Exchange, Boston Options Exchange, CBOE, International Securities Exchange, NYSE/Arca, The Options Clearing Corporation, Philadelphia Stock Exchange, dated Sept. 19, 2007 ("Options Exchanges"); letter from Susquehanna.

45 See letter from NCANS.

46 See letter from USANA; see also letter from Fairfax Financial (stating that the exception should be eliminated due to its "detrimental impact on issuers and their shareholders and also because such exception is susceptible to significant abuse").

selling short into the price of the put options being sold."[47] Commenters also stated that 13 consecutive settlement days was more than sufficient to close out a fail to deliver relating to an options position.[48]

Commenters who opposed the proposed amendments generally criticized the impact of elimination on options market making risk, quote depths, spread widths, and market liquidity in threshold securities and securities that might become threshold securities. Among other things, they stated that the options market maker exception is integral to the options market maker's ability to make markets and manage risk and that, without the exception, making continuous markets would be very difficult, particularly in longer-dated options.[49] One commenter suggested that "withdrawing or greatly reducing the exception would cause varying losses of liquidity in over 20% of listed options and their underlying stocks."[50] Another commenter stated that "[i]f the exception is eliminated or narrowed in the manner proposed, [it] anticipates [options market makers] would be reluctant or even unable to effectively make markets on securities if they cannot be certain of their ability to establish and maintain an effective hedge and manage their risk through selling stock."[51] Another commented that "[t]he uncertainty, time, processing and expense necessary to pre-borrow when effecting a short sale, as well as the uncertainty and expense caused by a close out of a hedge, will by its nature adversely affect the [options market makers'] pricing of the option."[52]

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47 See letter from Fairfax Financial.

48 See, e.g., letter from U.S. Chamber of Commerce.

49 See letter from CBOE.

50 See letter from Susquehanna.

51 See id; see also letter from Options Exchanges; Citigroup.

52 See letter from Citigroup.

Some commenters who opposed elimination of the exception argued that options market makers, unlike equity market makers, should have an exception to Regulation SHO's close-out requirement because there are distinct differences between options market making and market making in the underlying stock. For example, one commenter stated that the risk to an options market maker of trading options on a threshold security is higher than that of a stock specialist because in the equity markets there is often a natural flow of buyers and sellers to trade against each other without the stock specialist having to take a position.[53] According to the commenter, options market makers routinely have to take the other side of customer trades in the options transaction and must hedge the residual risk. This commenter also noted that when an options market maker must close out a fail to deliver position, it may have to worry about the risk and exposure for the options positions that were previously offset by the stock position.

Other commenters stated that equity market makers "can freely hedge an equity position in a threshold security with a short options position, but, if the options market maker exception is eliminated, options market makers would face restrictions in their ability to hedge options positions with the underlying equity."[54] These commenters stated that the ability to keep open a fail to deliver position is particularly important with longer-term options positions where the options market maker must maintain the hedge for extended periods of time.[55] In such circumstances, these commenters stated that often the only available and/or economically feasible hedge is the underlying security.

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53 See letter from CBOE.

54 See letter from Options Exchanges.

55 See, e.g., letter from Citigroup.

Some commenters also stated that the one-time 35 consecutive settlement day phase-in period was "particularly troubling because it would not be sufficient to account for pre-existing options positions that were assumed in reliance on the [options market maker exception]."[56] In particular, these commenters expressed concerns about increased costs and risks associated with having to close out previously-exempted fails to deliver relating to the hedging of longer-term options positions, such as Long-term Equity Anticipation Securities ("LEAPS"),[57] that were not anticipated at the time the options positions were originally taken.[58]

Some commenters also opposed the proposed alternatives. For example, one commenter stated that the "35-day window afforded options market makers to fail would simply create opportunities for sophisticated market participants to employ complex derivative strategies to roll failed positions from one period to the next."[59] Other commenters preferred the proposed 35 day close out alternative to elimination of the options market maker exception.[60] Some commenters, however, requested that the Commission extend the proposed alternative 35 day close-out requirement to 42 days[61] or even 45 days,[62] to allow for 2 options expirations before a fail to deliver position must be closed out.

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56 See letter from CBOE; see also letter from Options Exchanges.

57 LEAPS are long-term stock or index options. LEAPS, like all options, are available in two types, calls and puts, with expiration dates up to three years in the future. See http://www.cboe.com/LearnCenter/glossary_g-l.aspx#L (defining LEAPS).

58 See, e.g., letter from CBOE; Options Exchanges; Citigroup.

59 See letter from Overstock.

60 See, e.g., letter from CBOE; Options Exchanges; UBS.

61 See, e.g., letter from CBOE; Options Exchanges.

62 See letter from Susquehanna.

We also received a number of comment letters in response to the 2008 Regulation SHO Re-Opening Release, most of which urged the Commission to take action on the proposed amendments to eliminate the options market maker exception.[63] In contrast, one commenter noted that it does not believe that there is evidence of a significant problem with extended fails to deliver or, if such a problem exists, evidence that it is attributable to the options market maker exception.[64] In addition, this commenter stated that it believes "[t]he perceived benefits of modifying the exception . . . would not outweigh the costs associated and burden placed on OMMs and options market they support."[65]

As discussed in detail below, although we recognize commenters' concerns that elimination of the options market maker exception may place costs and burdens on options market makers, we believe that such potential effects are justified by the benefits that are expected to result from requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely.

B. Discussion of Amendments

After careful consideration of the comments, we are adopting amendments to eliminate the options market maker exception to Regulation SHO's close-out requirement. Specifically, as a result of the amendments, all fails to deliver in a threshold security resulting from short sales by a registered options market maker effected to establish or maintain a hedge on options positions established before the security became a threshold security will, like all other fails to

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63 Comment letters are available on the Commission's Internet Web site at http://www.sec.gov/comments/s7-19-07/s71907.shtml.

64 See letter from Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange, dated Aug. 15, 2008 ("CBOE 2008").

65 See id.

deliver in threshold securities, have to be closed out in accordance with the close-out requirements of Regulation SHO.[66]

The amendments include a one-time 35 consecutive settlement day phase-in period, as proposed.[67] Under this provision of the amendments, any previously excepted fail to deliver position in a threshold security on the effective date of the amendments, including any adjustments to that fail to deliver position, must be closed out within 35 consecutive settlement days of the effective date of the amendments.[68] We chose 35 settlement days because 35 days was used in Regulation SHO as adopted in August 2004, and in Regulation SHO, as amended.[69]

In the September Emergency Order, we adopted and made immediately effective the elimination of the options market maker exception to Regulation SHO's close-out requirement.[70] Thus, if there was a fail to deliver position at a registered clearing agency in a security that was a threshold security on the effective date of the September Emergency Order, participants of a registered clearing agency had to close out that position within 35 consecutive settlement days, regardless of whether the security became a non-threshold security after the effective date of the September Emergency Order. Because this release makes the elimination of the options market

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[66] Accordingly, the amendments remove the options market maker exception from Rule 203(b)(3)(iii) of Regulation SHO, as adopted. We note that we have adopted on an interim final temporary basis, temporary Rule 204T that strengthens the delivery requirements of Regulation SHO for sales of all equity securities such that fails to deliver must be closed out by no later than the beginning of regular trading hours on the settlement day following the day the participant incurred the fail to deliver position. The temporary rule has a limited exception from this close-out requirement for options market makers. See Interim Final Temporary Rule, supra at notes 42 and 43.

[67] See Adopted Rule 203(b)(3)(iii).

[68] If the security is a threshold security on the effective date of the amendments, participants of a registered clearing agency will have to close out that position within 35 consecutive settlement days, regardless of whether the security becomes a non-threshold security after the effective date of the amendments.

[69] See 2004 Regulation SHO Adopting Release, 69 FR at 48031; 2007 Regulation SHO Final Amendments, 72 FR at 45557.

[70] See supra note 40.

maker exception as set forth in the September Emergency Order permanent, and because the amendments contained in this release are effective on the expiration date of the September Emergency Order (i.e., October 17, 2008), any fails to deliver in threshold securities that were being closed out pursuant to the 35 consecutive settlement day phase-in period as set forth in the September Emergency Order will not receive an additional 35 consecutive settlement days from October 17, 2008 in which to be closed out. Instead, the 35 consecutive settlement days will continue to run from the effective date of the September Emergency Order. Any fails to deliver in securities that became threshold securities after the effective date of the September Emergency Order and that are still threshold securities on the effective date of these amendments, must be closed out in accordance with the current close-out requirements of Regulation SHO, rather than within 35 consecutive settlement days of the effective date of these amendments.[71]

Although, as noted above, some commenters stated that the one-time 35 consecutive settlement day phase-in period was "particularly troubling because it would not be sufficient to account for pre-existing options positions that were assumed in reliance on the [options market maker exception]"[72], we believe that a 35 consecutive settlement day phase-in period allows participants sufficient time to close out any previously excepted fail to deliver positions with limited disruption to the market and helps foster market stability because it provides participants with a sufficient length of time to effect purchases to close out these positions in an orderly manner.

We are also adopting our proposal that if the fail to deliver position persists for 35 consecutive settlement days from the effective date of the amendment, a participant of a

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71 For the duration of temporary Rule 204T, fails to deliver in all equity securities, regardless of whether or not the security is a threshold security, must be closed out in accordance with the requirements of the temporary rule.

72 <u>See</u>, <u>e.g.</u>, letter from CBOE.

registered clearing agency (and any broker-dealer for which it clears transactions, including any market maker), is prohibited from accepting any short sale orders or effecting further short sales in the particular threshold security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail to deliver position by purchasing securities of like kind and quantity.[73] Due to the requirements of the September Emergency Order, this provision of the amendments is applicable to those fails to deliver that may be closed out within 35 consecutive settlement days of the effective date of the September Emergency Order but are not closed out within that time-frame.

If a security becomes a threshold security after the effective date of the amendments, any fails to deliver that result or resulted from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the security became a threshold security will be subject to Regulation SHO's close-out requirements, similar to any other fail to deliver position in a threshold security.[74]

We believe that it is appropriate to eliminate Regulation SHO's options market maker exception because substantial levels of fails to deliver continue to persist in threshold securities and it appears that a significant number of these fails to deliver are as a result of the options market maker exception.[75] As noted above, the Commission staff obtained data from SROs, options market makers, and clearing agency participants that shows extensive use of the options market maker exception to Regulation SHO's close-out requirement and the resulting fails to

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73 See Adopted Rule 203(b)(3)(v).

74 See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

75 See 2008 Regulation SHO Re-Opening Release, 73 FR 40201.

deliver that were not closed out during 2006, 2007, and 2008.[76] For example, the data showed that as of January 31, 2008, a participant that settles and clears for a large segment of the options market claimed the options market maker exception to the close-out requirement in 16 threshold securities for a total of 6,365,158 fails to deliver. As of February 29, 2008, the data indicated that this participant claimed the options market maker exception in 20 threshold securities for a total of 6,963,949 fails to deliver. In addition, according to data provided by FINRA for 2007 relating to a participant that settles and clears for a large segment of the options market, fail to deliver positions not closed out by the participant due to it claiming the options market maker exception ranged from 35,655 fails to deliver in one month that year, to as much as 5,621,982 in another month that year. According to a review conducted by several SROs between May to July 2006, there were 598 exceptions claimed, covering 58 threshold securities for a total of 11,759,799 fails to deliver.[77]

In addition, following the elimination of the "grandfather" exception to Regulation SHO's close-out requirement, data collected by OEA indicates that although fails to deliver overall decreased slightly, fails to deliver in optionable threshold securities increased significantly. The "grandfather" exception was eliminated as of October 15, 2007 with a one-time phase in period which expired on December 5, 2007. The sample data used by OEA compares two time periods: April 9, 2007 – October 14, 2007, which is defined as the "pre-amendment period" and December 10, 2007 – March 31, 2008, which is defined as the "post-

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76 See id.

77 See id.

amendment period." Specifically, the results of OEA's analysis of fails to deliver before and after the elimination of Regulation SHO's "grandfather" exception show that:[78]

- The average daily number of optionable threshold securities increased by 25.0%.
- The average daily number of new fail to deliver positions in optionable threshold securities increased by 45.3%.
- For fails aged more than 17 days in optionable threshold securities, the average daily dollar value of fails to deliver increased by 73.4%.
- For fails aged more than 17 days in optionable threshold securities, the average daily number of fail to deliver positions increased by 30.7%.
- The average daily number of optionable threshold securities with fails aged more than 17 days increased by 40.9%.

The data shows a 25 percent increase in the number of optionable threshold securities and a substantial increase in fails to deliver in optionable threshold securities when comparing the pre- and post-amendment periods. As the OEA Memorandum notes "[o]ne explanation of these results is that the investors who previously failed to deliver in the equity market have now moved to the options market to establish a synthetic position. Since the option market makers still enjoy an exception to the close-out rule and tend to hedge their positions in the equity markets, the fails may now be coming from the option market makers instead of the equity investors themselves."[79]

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78 See id; see also Memorandum from the Commission's Office of Economic Analysis (dated June 9, 2008), which is available on the Commission's Internet Web site at http://www.sec.gov/comments/s7-19-07/s71907-562.pdf (the "OEA Memorandum").

79 See OEA Memorandum.

As discussed above, commenters opposing the proposed amendments criticized the impact of the proposals on options market making risk, quote depths, spread widths, and market liquidity, particularly in threshold securities and securities that might become threshold securities.[80] Although we recognize these commenters' concerns regarding a mandatory close-out requirement for fails to deliver in threshold securities underlying options positions, for the reasons outlined below, we believe these potential effects are justified by the benefits of requiring that fails to deliver in all threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely. In addition, we believe the overall market impact of these potential effects, if any, will be minimal.

First, as discussed above, large and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending. They can also be indicative of potentially manipulative conduct, such as abusive "naked" short selling. The deprivation of the benefits of ownership, as well as the perception that abusive "naked" short selling is occurring in certain securities, can undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to manipulative conduct.

In the Reproposal, we sought comment on whether the proposed amendments would promote capital formation, including whether the proposed increased short sale restrictions would affect investors' decisions to invest in certain equity securities. Commenters expressed concern about "naked" short selling causing a drop in an issuer's stock price and that it may limit an issuer's ability to access the capital markets.[81] We believe that, by requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than allowing

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80 See, e.g., letter from Citigroup.

81 See supra note 19.

them to continue indefinitely, there will be a decrease in the number of threshold securities with persistent and high levels of fails to deliver. If persistence on the threshold securities lists leads to an unwarranted decline in investor confidence about the security, the amendments should improve investor confidence about the security.[82] We also believe that the amendments should lead to greater certainty in the settlement of securities which should strengthen investor confidence in the settlement process. The reduction in fails to deliver and the resulting reduction in the number of securities on the threshold securities lists could result in increased investor confidence.

Thus, by eliminating the options market maker exception so that all fails to deliver in threshold securities that result from short sales effected to maintain or establish a hedge on options positions will have to be closed out in accordance with Regulation SHO's close-out requirements, we expect a reduction in the number of threshold securities with large and persistent fails to deliver and, thereby, offsetting any potential negative impact of such fails to deliver on the market for these securities.[83]

Second, while we recognize commenters' concerns that on a security-by-security basis the impact on options market maker costs, liquidity, quote depths, and spread widths may vary considerably, and in some cases, might be large,[84] we believe the overall market impact of the amendments will be minimal because the number of securities that will be impacted by the amendments will be relatively small. As previously noted by one commenter, a small number of securities that meet the definition of a "threshold security" have listed options, and those

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82 See letter from Overstock.

83 See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

84 See, e.g., letter from Options Exchanges.

securities form a very small percentage of all securities that have options traded on them.[85] In addition, OEA estimates that in July 2008, 451 (13.6%) of the 3,326 securities with options classes trading on at least one options market appeared on a threshold securities list for at least one day that month. Even though these securities may form a small percentage of all securities that have options traded on them, we are still concerned that these fails to deliver can have a disproportionate impact on the markets and shareholders.

Moreover, the options market maker exception only excepted from Regulation SHO's mandatory 13 consecutive settlement day close-out requirement those fail to deliver positions resulting from short sales effected by registered options market makers to establish or maintain a hedge on options positions established before the underlying security became a threshold security. Thus, it did not apply to fails to deliver resulting from short sales effected to establish or maintain a hedge on options positions established after the underlying security became a threshold security. Because the options market maker exception had a very limited application, the overall impact of its removal on liquidity, hedging costs, spreads, and depth, should be relatively small. Nevertheless, we understand commenters' concerns that on a security-by-security basis the impact on options market maker costs might, in some cases, be large. However, on balance, we believe such costs are justified by the benefits that are expected to result from requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely.

Third, some commenters noted concerns about having to close out fails to deliver in connection with the hedging of longer-term options because such fails may have been open for

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85 For example, in its letter, Susquehanna noted that in June 2007, 174 (8%) of the 2,242 stocks with options classes trading on the CBOE, appeared on a threshold list for at least one day that month. See letter from Susquehanna.

months or years.[86] These commenters suggested that with respect to such fails to deliver, the close-out requirement be tied to the expiration or liquidation of such options. However, this would mean that these fails to deliver could persist for months or years. We believe that all fails to deliver in threshold securities must be closed out in a timely manner. Longer-term options can have expiration periods that extend for years. To tie the close out of a fail to deliver position resulting from a hedge of such options to the liquidation or expiration of such options would undermine this goal. As discussed above, large and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending. We also believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased.

In addition, the 35 consecutive settlement day phase-in period of the amendments allows participants sufficient time to close out any previously excepted fail to deliver positions that may have been open for months or years as a result of hedging activity in connection with longer-term options. The phase-in period limits the disruption to the market and helps foster market stability because it provides participants with a sufficient length of time to effect purchases to close out these positions in an orderly manner.

Fourth, the potential impact of the amendments on options market making risk, quote depths, spread widths, and market liquidity will be limited because, as noted above, Regulation SHO's options market maker exception applied only to those fail to deliver positions that resulted from short sales effected by registered options market makers to establish or maintain a hedge on options positions established before the underlying security became a threshold

86 See, e.g., letter from CBOE; Options Exchanges; Citigroup.

security. Thus, it did not apply to fails to deliver resulting from short sales effected to establish or maintain a hedge on options positions established after the underlying security became a threshold security. Some commenters stated that they believe there has been harm to the markets under the current close out structure of Regulation SHO.[87] As we noted in the Reproposal, however, in examining the application of the mandatory close-out requirement of Rule 203(b)(3) of Regulation SHO for all non-excepted fail to deliver positions, it does not appear that Rule 203(b)(3)'s close-out requirement for non-excepted fails to deliver in threshold securities has impacted options market makers' willingness to provide liquidity in threshold securities or securities likely to become threshold securities, or substantially impacted option market maker risk, quote depths, or spread widths.

In addition, we note that options market makers may only need to hedge via a short sale in the equity markets for a small fraction of their total trading activity. Academic research suggests that non-market maker option open interest tends to heavily favor the upside, which implies that the customary hedge for the typical option market making position is a long equity position rather than a short equity position.[88] More recent data from January to July 2008 also suggests an upside bias in option open interest.[89]

Fifth, while commenters may believe that a mandatory close-out requirement for all fails to deliver resulting from hedging activity in the options markets may potentially impact liquidity, hedging costs, depth, or spreads, or impact the willingness of options market makers to make markets in certain securities, we believe that such effects are justified by our belief that fails to

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[87] See, e.g., letter from CBOE; see also letter from Overstock.

[88] See Lakonishok, Poteshman, and Lee, "Investor Behavior and the Options Markets," Working Paper 10264 (2004) (http://www.nber.org/papers/w10264.pdf.).

[89] Data from The Options Clearing Corporation web site shows that call open interest generally exceeded put open interest by about 10% on the average day during January to July 2008.

deliver resulting from hedging activities by options market makers should be treated similarly to fails to deliver resulting from sales in the equities markets so that market participants trading threshold securities in the options markets do not receive an advantage over those trading such securities in the equities markets.

As discussed above, commenters who opposed elimination of the exception argued that options market makers, unlike equity market makers, should have an exception to Regulation SHO's close-out requirement because there are distinct differences between options market making and market making in the underlying stock. We do not believe that for purposes of the close-out requirement of Regulation SHO, options and equity market makers should be treated differently. Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continue to observe a small number of threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, we adopted amendments to eliminate Regulation SHO's "grandfather" provision that allowed fails to deliver resulting from long or short sales of equity securities to persist indefinitely if the fails to deliver occurred prior to the security becoming a threshold security.[90] We believe that once a security becomes a threshold security, fails to deliver in that security must be closed out, regardless of whether or not the fails to deliver resulted from sales of the security in connection with the options or equities markets.

Moreover, we are concerned that the options market maker exception might have allowed for a regulatory arbitrage not permitted in the equities markets.[91] For example, an options market maker who sells short to hedge put options purchased by a market participant unable to

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[90] See 2007 Regulation SHO Final Amendments, 72 FR 45544; see also 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

[91] See Reproposal, 72 FR at 45563.

locate shares for a short sale in accordance with Rule 203(b)(2) of Regulation SHO may not have to close out any fails to deliver that result from such short sales under the options market maker exception. The ability of options market makers to sell short and never have to close out a resulting fail to deliver position, provided the short sale was effected to hedge options positions created before the security became a threshold security, runs counter to the goal of requiring that all fails to deliver in threshold securities be closed out.

In addition, we note that although the proposed alternatives could lessen the potential negative impact of large and persistent fails to deliver, we believe that complete elimination of the options market maker exception would achieve this goal more effectively. By eliminating the options market maker exception, all fails to deliver in threshold securities will have to be closed out in accordance with Regulation SHO's close-out requirements.[92] The proposed alternatives, however, would each allow a longer period of time for fail to deliver positions to be closed out. Specifically, the first alternative would allow certain fails to deliver to be closed out within 35 consecutive settlement days of the security becoming a threshold security. Under the second alternative, although some fails to deliver would be required to be closed out in less than 35 consecutive settlement days, other fails to deliver would not have to be closed out until 35 consecutive settlement days from the security becoming a threshold security.[93]

As we discussed in the Reproposal,[94] we believe that the options market maker exception should be eliminated, rather than limited as in the proposed alternatives, because large and persistent fails to deliver are not being closed out under existing delivery requirements and

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[92] See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

[93] See Reproposal, 72 FR at 45589-45590.

[94] See id. at 45566-45567.

because we are concerned that these fails to deliver may have a negative impact on the market for those securities. In addition, as noted in the Reproposal, we believe that fails to deliver resulting from hedging activities by options market makers should be treated similarly to fails to deliver resulting from sales in the equities markets so that market participants trading threshold securities in the options markets do not receive an advantage over those trading such securities in the equities markets. Thus, we have determined that the proposed alternatives are not feasible or in the public interest to act upon at this time.

IV. Bona-Fide Market Making

We are also taking the opportunity to provide guidance regarding issues that have arisen regarding what is bona-fide market making for purposes of complying with the market maker exception to the "locate" requirement of Rule 203(b)(1) of Regulation SHO. The 2004 Regulation SHO Adopting Release provides guidance as to what is bona-fide market making. We are reiterating that guidance and providing additional guidance in this adopting release.

Rule 203(b)(1) provides that "[a] broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1)."[95] This is known as the "locate" requirement. Rule 203(b)(2)(iii) excepts market makers engaged in bona-fide market making activities from the locate requirement. The Commission adopted this narrow exception to the locate requirement

[95] 17 CFR 242.203(b).

because such market makers may need to facilitate customer orders in a fast moving market without possible delays associated with complying with the locate requirement.[96]

The term "market maker" includes any specialist permitted to act as a dealer, any dealer acting in the capacity of a block positioner, and any dealer who, with respect to a security, holds itself out (by entering quotations in an inter-dealer quotation system or otherwise) as being willing to buy and sell such security for its own account on a regular or continuous basis.[97] Moreover, as the Commission has stated previously, a market maker engaged in bona-fide market making is a "broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security as well as regularly and continuously placing quotations in a quotation medium on both the bid and ask side of the market."[98] We note that block positioners, to the extent they engage in bona fide block positioning activities, may also rely on this exception from the locate requirement in connection with such activities. Rule 3b-8(c) of the Exchange Act (17 CFR 240.3b-8(c)) defines a "qualified block positioner" as a dealer that: (1) is a broker or dealer registered pursuant to Section 15 of the Exchange Act; (2) is subject to and in compliance with Rule 15c3-1 of the Exchange Act (17 CFR 240.15c3-1); (3) has and maintains minimum net capital, as defined in Rule 15c3-1, of $1,000,000; and (4) except when such activity is unlawful, meets all of the following conditions: (i) engages in the activity of purchasing long or selling short, from time to time, from or to a customer (other than a partner or

96 See 2004 Regulation SHO Adopting Release, 69 FR at 48015, n. 67; see also Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Exchange Act Release No. 58166 (July 15, 2008); Amendment to Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, Exchange Act Release No. 58190 (July 18, 2008) (excepting from the Emergency Order bona fide market makers).

97 See 2004 Regulation SHO Adopting Release, 69 FR at 48015, n. 66 (citing to Section 3(a)(38) of the Exchange Act).

98 See Exchange Act Release No. 32632 (July 14, 1993), 58 FR 39072, 39074 (July 21, 1993).

a joint venture or other entity in which a partner, the dealer, or a person associated with such dealer, as defined in Section 3(a)(18) of the Exchange Act, participates) a block of stock with a current market value of $200,000 or more in a single transaction, or in several transactions at approximately the same time, from a single source to facilitate a sale or purchase by such customer, (ii) has determined in the exercise of reasonable diligence that the block could not be sold to or purchased from others on equivalent or better terms, and (iii) sells the shares comprising the block as rapidly as possible commensurate with the circumstances.

As discussed below, in the 2004 Regulation Adopting Release, we provided examples of the types of activities that would indicate that a market maker is not engaged in bona fide market making activities. In addition to reiterating that guidance, we are also providing examples of the types of activities that would indicate that a market maker is engaged in bona fide market making activities for purposes of claiming the exception to Regulation SHO's locate requirement.

Although determining whether or not a market maker is engaged in bona-fide market making would depend on the facts and circumstances of the particular activity, factors that indicate a market maker is engaged in bona-fide market making activities may include, for example, whether the market maker incurs any economic or market risk with respect to the securities (e.g., by putting their own capital at risk to provide continuous two-sided quotes in markets). In fulfilling its obligations as a market maker, a market maker engaged in bona-fide market making may provide liquidity to a security's market, take the other side of trades when there are short-term buy-and-sell-side imbalances in customer orders, or attempt to prevent excess volatility. Such activities will result in the market maker assuming some risk. Thus, if the market maker does not incur any market risk with respect to a transaction or related set of transactions, the market maker may not be engaged in bona-fide market making activities.[99]

A pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers would generally be an indication that a market maker is engaged in bona-fide market making activity. Thus, even selling short into a declining market may be an indication that a market maker is engaged in bona-fide market making activity. Continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely accessible to investors and other broker-dealers are also an indication that a market maker is engaged in bona-fide market making activity. However, as noted above, a market maker must hold itself out as being willing to buy and sell a security for its own account on a regular or continuous basis. Thus, a market maker's quotes must be generally accessible to the public for a market maker to be considered as holding itself out as being willing to buy and sell a security for its own account on a regular or continuous basis, and therefore, to be engaged in bona-fide market making activity.

While determining whether or not a market maker is engaged in bona-fide market making would depend on the facts and circumstances of the particular activity, there are clear examples of what types of activities would not be bona-fide market making activities. For example, the Commission has stated that bona-fide market making does not include activity that is related to speculative selling strategies or investment purposes of the broker-dealer and is disproportionate

[99] For example, if a market maker sells stock (short) together with a synthetic short position (e.g., a conversion) to a client and the client then sells the stock (long) retaining the synthetic short position, the effect would be as if the market maker had "rented" its exemption to the client. Such transactions or other transactions that have the same effect will not be considered bona-fide market making activity.

to the usual market making patterns or practices of the broker-dealer in that security.[100] Likewise, where a market maker posts continually at or near the best offer, but does not also post at or near the best bid, the market maker's activities would not generally qualify as bona-fide market making.[101] Moreover, a market maker that continually executes short sales away from its posted quotes would generally not be considered to be engaging in bona-fide market making.[102] For purposes of qualifying for the locate exception in Regulation SHO, a market maker must also be a market maker in the security being sold, and must be engaged in bona-fide market making in that security at the time of the short sale.[103]

V. Other Matters

The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[104] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[105]

As noted above, in the September Emergency Order, we adopted, and made immediately effective, amendments to Rule 203(b)(3) of Regulation SHO to eliminate the options market maker exception to Regulation SHO's close-out requirement. The September Emergency Order expires on October 17, 2008. We believe that the amendments contained in this adopting release should be effective on October 17, 2008 so that the elimination of the options market maker exception becomes permanent when the September Emergency Order expires. In addition, we

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100 See 2004 Regulation SHO Adopting Release, 69 FR at 48015.

101 See id.

102 See id.

103 See Rule 203(b)(1) and (b)(2)(iii).

104 See 5 U.S.C. §553(d).

105 Id.

believe that the amendments should become effective on October 17, 2008 so that fails to deliver resulting from short sales in both the equity and options markets receive similar treatment under the close-out requirements of Regulation SHO, and to further reduce fails to deliver and address potentially abusive "naked" short selling. Thus, the Commission finds good cause to make the amendments effective on October 17, 2008.

VI. Paperwork Reduction Act

The amendments to Regulation SHO do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[106]

VII. Consideration of Costs and Benefits of Proposed Amendments to Regulation SHO

We are sensitive to the costs and benefits of our rules and we have considered the costs and the benefits of the amendments to Regulation SHO. In order to assist us in evaluating the costs and benefits, in the Reproposal, we encouraged commenters to discuss any costs or benefits that the amendments might impose. In particular, we requested comment on the potential costs for any modifications to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the amendments for registrants, issuers, investors, brokers or dealers, other securities industry professionals, regulators, and other market participants. Commenters were encouraged to provide analysis and data to support their views on the costs and benefits associated with the amendments to Regulation SHO.

A. Benefits

The amendments to Rule 203(b)(3) of Regulation SHO are intended to further reduce the number of persistent fails to deliver in threshold securities by eliminating the options market

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106 44 U.S.C. 3501 et seq.

maker exception to Regulation SHO's close-out requirement. As a result of the amendments, all fails to deliver in a threshold security resulting from short sales by a registered options market maker effected to establish or maintain a hedge on options positions established before the security became a threshold security will, like all other fails to deliver in threshold securities, have to be closed out in accordance with Regulation SHO's close-out requirements.[107]

We are concerned that large and persistent fails to deliver are not being closed out due to the options market maker exception in Regulation SHO, and that these fails to deliver may have a negative effect on the market in these securities.[108] For example, large and persistent fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.[109] In addition, where a seller of securities fails to deliver securities on trade settlement date, in effect the seller unilaterally converts a securities contract (which should settle within the standard 3-day settlement period) into an undated futures-type contract, to which the buyer may not have agreed, or that would have been priced differently.[110] Moreover, sellers that fail to deliver securities on settlement date may enjoy fewer restrictions than if they were required to deliver the securities in a timely manner, and such sellers may attempt to use this additional freedom to engage in trading activities that deliberately depress the price of a security.[111] In addition, by not borrowing securities and, therefore, not making delivery within the standard three-day settlement period, the seller avoids the costs of borrowing.

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107 See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

108 See 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; Reproposal, 72 FR at 45558-45559; "Naked" Short Selling Anti-Fraud Rule Proposing Release, 73 FR at 15378.

109 See id.

110 See id.

111 See id.

Thus, consistent with the Commission's investor protection mandate, the amendments will benefit investors by facilitating the receipt of shares so that more investors receive the benefits associated with share ownership, such as the use of the shares for voting and lending purposes. The amendments will also enhance investor confidence as they make investment decisions by providing investors with greater assurance that securities will be delivered as expected. An increase in investor confidence in the market should facilitate investment.

The amendments will also benefit issuers. A high level of persistent fails to deliver in a security may be perceived by potential investors negatively and may affect their decision about making a capital commitment.[112] For example, in response to the Reproposal, one commenter stated that it believes that the current options market maker exception "harms investors and issuers, hinders the formation of capital, and is fatally flawed as written" and that it should be eliminated.[113] Some issuers may believe that they have endured unwarranted reputational damage due to investors' negative perceptions regarding a security having a large fail to deliver position and becoming a threshold security.[114] Thus, issuers may believe the elimination of the options market maker exception will restore their good name. Some issuers may also believe that large and persistent fails to deliver indicate that they have been the target of potentially manipulative conduct as a result of "naked" short selling.[115] Thus, elimination of the options

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[112] See, e.g., supra note 19 (citing to comment letters expressing concern regarding the impact of potential "naked" short selling on capital formation).

[113] See letter from NCANS.

[114] See, e.g., supra note 18; see also letter from Fairfax Financial (stating that the exception should be eliminated due to its "detrimental impact on issuers and their shareholders and also because such exception is susceptible to significant abuse").

[115] See, e.g., supra note 19 (citing to comment letters from issuers and investors discussing extended fails to deliver in connection with "naked" short selling).

market maker exception should decrease the possibility of artificial market influences and, therefore, should contribute to price efficiency.

B. Costs

To comply with Regulation SHO when it became effective in January 2005, market participants needed to modify their recordkeeping systems and surveillance mechanisms. In addition, market participants should have retained and trained the necessary personnel to ensure compliance with the rule. Thus, the infrastructure necessary to comply with the amendments should already be in place because the amendments will require that all fails to deliver be closed out in accordance with the close-out requirements of Regulation SHO.[116] The only fails to deliver not subject to Regulation SHO's mandatory close-out requirements will be those fails to deliver that would be previously-excepted from the close-out requirement and, therefore, eligible for the one-time 35 consecutive settlement day phase-in period of the amendments.[117] Thus, we anticipate that any changes to personnel, computer hardware and software, recordkeeping or surveillance costs will be minimal.

In the Reproposal, we requested comment regarding the costs of the proposed amendments to the options market maker exception and how those costs would affect liquidity in the options markets. As discussed above, commenters opposing the proposed amendments criticized the impact of the proposals on options market making risk, quote depths, spread widths, and market liquidity, particularly in threshold securities and securities that might become threshold securities. These commenters stated that the current exception is integral to the options market maker's ability to make markets and manage risk and that, without the exception, making

[116] See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

[117] See Adopted Rule 203(b)(3)(iii).

continuous markets would be very difficult, particularly in longer-dated options.[118] One commenter suggested that "withdrawing or greatly reducing the exception would cause varying losses of liquidity in over 20% of listed options and their underlying stocks."[119] Another commenter stated that "[i]f the exception is eliminated or narrowed in the manner proposed, [it] anticipates [options market makers] would be reluctant or even unable to effectively make markets on securities if they cannot be certain of their ability to establish and maintain an effective hedge and manage their risk through selling stock."[120] Another commented that "[t]he uncertainty, time, processing and expense necessary to pre-borrow when effecting a short sale, as well as the uncertainty and expense caused by a close out of a hedge, will by its nature adversely affect the [options market makers'] pricing of the option."[121] However, one commenter noted that "options market makers should factor the cost of borrowing stock and selling short into the price of the put options being sold."[122] Another commenter noted that "[o]ptions market makers should have to pay to borrow stock like everyone else does. Most options market makers are excellent risk managers, and they can manage the risk that stock borrowing costs can fluctuate. Any additional costs involved will rightfully be passed to those who trade options."[123]

Although we recognize commenters' concerns that a mandatory close-out requirement for fails to deliver in threshold securities underlying options positions, for the reasons outlined below, we believe these potential effects are justified by the benefits of requiring that fails to

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118 See letter from CBOE.

119 See letter from Susquehanna.

120 See id.; see also letter from Options Exchanges; Citigroup.

121 See letter from Citigroup.

122 See letter from Fairfax Financial.

123 See letter from Angel.

deliver in all threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely. In addition, we believe the overall market impact of these potential effects, if any, will be minimal.

First, as discussed above, large and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending. They can also be indicative of potentially manipulative conduct, such as abusive "naked" short selling. The deprivation of the benefits of ownership, as well as the perception that abusive "naked" short selling is occurring in certain securities, can undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to manipulative conduct.

In the Reproposal, we sought comment on whether the proposed amendments would promote capital formation, including whether the proposed increased short sale restrictions would affect investors' decisions to invest in certain equity securities. Commenters expressed concern about "naked" short selling causing a drop in an issuer's stock price and that it may limit an issuer's ability to access the capital markets.[124] We believe that, by requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than allowing them to continue indefinitely, there will be a decrease in the number of threshold securities with persistent and high levels of fails to deliver. If persistence on the threshold securities lists leads to an unwarranted decline in investor confidence about the security, the amendments should improve investor confidence about the security.[125] We also believe that the reduction in fails to deliver and the resulting reduction in the number of securities on the threshold securities lists should strengthen investor confidence and increase certainty in the settlement process.

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124 See supra note 19.

125 See letter from Overstock.

Thus, by eliminating the options market maker exception so that all fails to deliver in threshold securities that result from short sales effected to maintain or establish a hedge on options positions will have to be closed out in accordance with Regulation SHO's close-out requirements,[126] we expect a reduction in the number of threshold securities with large and persistent fails to deliver and, thereby, offsetting any potential negative impact of such fails to deliver on the market for these securities.

Second, while we recognize commenters' concerns that on a security-by-security basis the impact on options market maker costs, liquidity, quote depths, and spread widths may vary considerably, and in some cases, might be large,[127] we believe the overall market impact of the amendments will be minimal because the number of securities that will be impacted by the amendments will be relatively small. As previously noted by one commenter, a small number of securities that meet the definition of a "threshold security" have listed options, and those securities form a very small percentage of all securities that have options traded on them.[128] In addition, OEA estimates that in July 2008, 451 (13.6%) of the 3,326 securities with options classes trading on at least one options market appeared on a threshold securities list for at least one day that month. Even though these securities may form a small percentage of all securities that have options traded on them, we are still concerned that these fails to deliver can have a disproportionate impact on the markets and shareholders.

Moreover, the options market maker exception only excepted from Regulation SHO's mandatory 13 consecutive settlement day close-out requirement only those fail to deliver

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[126] See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

[127] See, e.g., letter from Options Exchanges.

[128] See supra note 85.

positions that resulted from short sales effected by registered options market makers to establish or maintain a hedge on options positions established before the underlying security became a threshold security. Thus, it does not apply to fails to deliver resulting from short sales effected to establish or maintain a hedge on options positions established after the underlying security became a threshold security. Because the options market maker exception has a very limited application, we anticipate that the overall impact of its removal on liquidity, hedging costs, spreads, and depth should be relatively small. Nevertheless, we understand commenters' concerns that on a security-by-security basis the impact on options market maker costs might, in some cases, be large. However, on balance, we believe such costs are justified by the benefits that are expected to result from requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely.

Third, some commenters noted concerns about having to close out fails to deliver in connection with the hedging of longer-term options because such fails may have been open for months or years.[129] These commenters suggested that with respect to such fails to deliver, the close-out requirement be tied to the expiration or liquidation of such options. However, this would mean that these fails to deliver could persist for months or years. We believe that all fails to deliver in threshold securities must be closed out in a timely manner. Longer-term options can have expiration periods that extend for years. To tie the close out of a fail to deliver position resulting from a hedge of such options to the liquidation or expiration of such options would undermine this goal. As discussed above, large and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending. We also believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the

[129] See, e.g., letter from CBOE; Options Exchanges; Citigroup.

respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased.

In addition, the 35 consecutive settlement day phase-in period of the amendments allows participants sufficient time to close out any previously excepted fail to deliver positions that may have been open for month or years as a result of hedging activity in connection with longer-term options. The phase-in period limits the disruption to the market and helps foster market stability because it provides participants with a sufficient length of time to close out these positions in an orderly manner.

Fourth, the potential impact of the amendments on options market making risk, quote depths, spread widths, and market liquidity will be limited because, as noted above, Regulation SHO's options market maker exception applied only to those fail to deliver positions that resulted from short sales effected by registered options market makers to establish or maintain a hedge on options positions established before the underlying security became a threshold security. Thus, it does not apply to fails to deliver resulting from short sales effected to establish or maintain a hedge on options positions established after the underlying security became a threshold security. Some commenters stated that they believe there has been harm to the markets under the current close out structure of Regulation SHO.[130] As we noted in the Reproposal, however, in examining the application of the mandatory close-out requirement of Rule 203(b)(3) of Regulation SHO for all non-excepted fail to deliver positions, it does not appear that Rule 203(b)(3)'s close-out requirement for non-excepted fails to deliver in threshold securities has impacted options market makers' willingness to provide liquidity in threshold securities or

[130] See, e.g., letter from CBOE; see also letter from Overstock.

securities likely to become threshold securities, or substantially impacted option market maker risk, quote depths, or spread widths.

We also note that option market makers may only need to hedge via a short sale in the equity markets for a small fraction of their total trading activity. Academic research suggests that non-market maker option open interest tends to heavily favor the upside, which implies that the customary hedge for the typical option market making position is a long equity position rather than a short equity position.[131] More recent data from January to July 2008 also suggests an upside bias in option open interest.[132]

Fifth, while commenters may believe that a mandatory close-out requirement for all fails to deliver resulting from hedging activity in the options markets may potentially impact liquidity, hedging costs, depth, or spreads, or impact the willingness of options market makers to make markets in certain securities, we believe that such potential effects are justified by our belief that fails to deliver resulting from hedging activities by options market makers should be treated similarly to fails to deliver resulting from sales in the equities markets so that market participants trading threshold securities in the options markets do not receive an advantage over those trading such securities in the equities markets.

As discussed above, commenters who opposed elimination of the exception argued that options market makers, unlike equity market makers, should have an exception to Regulation SHO's close-out requirement because there are distinct differences between options market making and market making in the underlying stock. We do not believe that for purposes of the close-out requirement of Regulation SHO, options and equity market makers should be treated

131 See supra note 88.

132 See supra note 89.

differently. Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continue to observe a small number of threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, we adopted amendments to eliminate Regulation SHO's "grandfather" provision that allowed fails to deliver resulting from long or short sales of equity securities to persist indefinitely if the fails to deliver occurred prior to the security becoming a threshold security.[133] We believe that once a security becomes a threshold security, fails to deliver in that security must be closed out, regardless of whether or not the fails to deliver resulted from sales of the security in connection with the options or equities markets.

Moreover, we are concerned that the options market maker exception might have allowed for a regulatory arbitrage not permitted in the equities markets.[134] For example, an options market maker who sells short to hedge put options purchased by a market participant unable to locate shares for a short sale in accordance with Rule 203(b)(2) of Regulation SHO may not have to close out any fails to deliver that result from such short sales under the options market maker exception. The ability of options market makers to sell short and never have to close out a resulting fail to deliver position, provided the short sale was effected to hedge options positions created before the security became a threshold security, runs counter to the goal of requiring that all fails to deliver in threshold securities be closed out.

Also, the pre-borrow requirement of Adopted Rule 203(b)(3)(v) for fail to deliver positions that are not closed out within the applicable time-frame set forth in the amendments will result in limited, if any, costs to participants of a registered clearing agency, and options

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[133] See 2007 Regulation SHO Final Amendments, 72 FR 45544; see also 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

[134] Reproposal, 72 FR at 45563.

market makers for which they clear transactions.[135] The pre-borrow requirement is similar to the pre-borrow requirement of Rule 203(b)(3)(iv) of Regulation SHO relating to fails to deliver that have not been closed out in accordance with the 13 consecutive settlement day close-out requirement of Regulation SHO.[136] Thus, participants of a registered clearing agency, and any options market maker for which it clears transactions, must already comply with such a requirement if a fail to deliver position has not been closed out in accordance with Regulation SHO's mandatory close-out requirement. Accordingly, these entities should already have in place the personnel, recordkeeping, systems, and surveillance mechanisms necessary to comply with the adopted pre-borrow requirement. While the pre-borrow requirement may be costly in each instance it is used, pre-borrowing is not necessary if a close-out is completed on time and, therefore, may be used only rarely.

VIII. Consideration of Burden and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.[137] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[138] Exchange Act Section 23(a)(2) prohibits the Commission from

[135] See Adopted Rule 203(b)(3)(v).

[136] See 17 CFR 242.203(b)(3)(iv).

[137] 15 U.S.C. 78c(f).

[138] 15 U.S.C. 78w(a)(2).

adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe the amendments will have minimal impact on the promotion of price efficiency. In the Reproposal, we sought comment on whether the amendments would promote price efficiency. Commenters expressed concern that failures to deliver due to the options market maker exception harm pricing efficiency in the equity markets.[139] Other commenters stated that the proposed amendments to the options market maker exception would disrupt the markets because they would not provide sufficient flexibility to permit efficient hedging by options market makers, would unnecessarily increase risks and costs to hedge, and would adversely impact liquidity and result in higher costs to customers.[140] These commenters stated that they believe the proposed amendments would likely discourage options market makers from making markets in illiquid securities since the risk associated in maintaining the hedges in these option positions would be too great.[141] Moreover, these commenters stated that the reluctance of options market makers to make markets in threshold securities would result in wider spreads in such securities to account for the increased costs of hedging, to the detriment of investors.[142]

We recognize commenters' concerns that a mandatory close-out requirement for fails to deliver in threshold securities underlying options positions may potentially impact options market makers' willingness to provide liquidity in threshold securities, make it more costly for options market makers to accommodate customer orders, or result in wider bid-ask spreads or

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139 See, e.g., letter from Overstock.

140 See, e.g., letter from Options Exchanges.

141 See id.

142 See letter from Citigroup.

less depth.[143] For the reasons discussed below, however, we believe that the overall impact of these potential effects, if any, will be minimal.

We believe that the overall market impact of the amendments will be minimal because the number of securities that will be impacted by the amendments will be relatively small. The amendments apply only to those threshold securities with listed options. As previously noted by one commenter, a small number of securities that meet Regulation SHO's definition of a "threshold security" have listed options, and those securities form a very small percentage of all securities that have options traded on them.[144] In addition, the amendments will only impact fails to deliver in those securities that resulted from short sales by registered options market makers to hedge options positions that were created before, rather than after, the security became a threshold security because all other fails to deliver in threshold securities are already subject to Regulation SHO's close-out requirements.[145]

Because the options market maker exception has a very limited application, we anticipate that the overall impact of its removal on liquidity, hedging costs, spreads, and depth will be relatively small. Nevertheless, we understand commenters' concerns that on a security-by-security basis the impact on options market maker costs might, in some cases, be large. However, on balance, we believe such costs are justified by the benefits that are expected to result from requiring that all fails to deliver in threshold securities be closed out within specific time-frames rather than being allowed to continue indefinitely.

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143 See, e.g., letter from CBOE.

144 See supra note 85.

145 See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

We also note that option market makers may only need to hedge via a short sale in the equity markets for a small fraction of their total trading activity. Academic research suggests that non-market maker option open interest tends to heavily favor the upside, which implies that the customary hedge for the typical option market making position is a long equity position rather than a short equity position.[146] More recent data from January to July 2008 also suggests an upside bias in option open interest.[147]

In addition, the 35 consecutive settlement day phase-in period of the amendments allows participants sufficient time to close out any previously excepted fail to deliver positions that may have been open for months or years as a result of hedging activity in connection with longer-term options. The phase-in period limits the disruption to the market, and helps foster market stability by providing participants with a sufficient length of time to close out these positions in an orderly manner. Some of the commenters to the Reproposal also noted that 13 consecutive settlement days was more than sufficient to close out a fail to deliver relating to an options position.[148]

While commenters may believe that a mandatory close-out requirement may potentially impact liquidity, hedging costs, depth, or spreads, or impact the willingness of options market makers to make markets in securities subject to such a requirement, we believe such potential effects are justified by our belief that fails to deliver resulting from hedging activities by options market makers should be treated similarly to fails to deliver resulting from sales in the equities markets so that market participants trading threshold securities in the options markets do not

146 See supra note 88.

147 See supra note 89.

148 See, e.g., letter from U.S. Chamber of Commerce.

receive an advantage over those trading such securities in the equities markets. In addition, we believe that such potential costs are justified by the benefits of requiring that all fails to deliver be closed out rather than being allowed to continue indefinitely.

We also believe that the amendments will have minimal impact on the promotion of capital formation. Large and persistent fails to deliver can deprive shareholders of the benefits of ownership, such as voting and lending. They can also be indicative of potentially manipulative conduct, such as abusive "naked" short selling. The deprivation of the benefits of ownership, as well as the perception that abusive "naked" short selling is occurring in certain securities, can undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.

In the Reproposal, we sought comment on whether the proposed amendments would promote capital formation, including whether the proposed increased short sale restrictions would affect investors' decisions to invest in certain equity securities. Commenters expressed concern about the potential impact of "naked" short selling on capital formation claiming that "naked" short selling causes a drop in an issuer's stock price that may limit the issuer's ability to access the capital markets.[149] Another commented that the options market maker exception "is a well known tool of manipulators and must be removed to ensure a level playing field for public companies and their shareholders."[150] In addition, one commenter stated that it believes that the

[149] See, e.g., supra note 19 (citing to comment letters expressing concern regarding the impact of potential "naked" short selling on capital formation).

[150] See letter from USANA; see also letter from Fairfax Financial (stating that the exception should be eliminated due to its "detrimental impact on issuers and their shareholders and also because such exception is susceptible to significant abuse").

current options market maker exception "harms investors and issuers, hinders the formation of capital, and is fatally flawed as written" and that it should be eliminated.[151]

By requiring that all fails to deliver in threshold securities be closed out rather than allowing them to continue indefinitely, we believe that there will be a decrease in the number of threshold securities with persistent and high levels of fails to deliver. If persistence on the threshold securities lists leads to an unwarranted decline in investor confidence about the security, the amendments should improve investor confidence about the security. We also believe that the amendments will lead to greater certainty in the settlement of securities which should strengthen investor confidence in the settlement process. The reduction in fails to deliver and the resulting reduction in the number of securities on the threshold securities lists may result in increased investor confidence.

The amendments to eliminate the options market maker exception will also not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. By eliminating the options market maker exception, the Commission believes the amendments will promote competition by requiring similarly situated participants of a registered clearing agency, including broker-dealers for which they clear transactions, to close out fails to deliver in all threshold securities within similar time-frames.[152] One commenter, in particular,

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151 See letter from NCANS.

152 Academic research suggests that the ability for all option market makers to fail when hedging actually creates a competitive advantage for large option market makers over small option market makers. See, e.g., Evans, Richard B., Reed, Adam V., Geczy, Christopher Charles and Musto, David K. "Failure is an Option: Impediments to Short Selling and Options Prices," Rev. Financ. Stud. (January 2008). The elimination of the options market maker exception, therefore, will remove this competitive advantage.

noted that the options market maker exception "is a well known tool of manipulators and must be removed to ensure a level playing field for public companies and their shareholders."[153]

As discussed above, commenters who opposed elimination of the exception argued that options market makers, unlike equity market makers, should have an exception to Regulation SHO's close-out requirement because there are distinct differences between options market making and market making in the underlying stock. We do not believe that for purposes of the close-out requirement of Regulation SHO, options and equity market makers should be treated differently. Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continue to observe a small number of threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, we adopted amendments to eliminate Regulation SHO's "grandfather" provision that allowed fails to deliver resulting from long or short sales of equity securities to persist indefinitely if the fails to deliver occurred prior to the security becoming a threshold security.[154] We believe that once a security becomes a threshold security, fails to deliver in that security must be closed out, regardless of whether or not the fails to deliver resulted from sales of the security in connection with the options or equities markets.

Moreover, we are concerned that the options market maker exception might allow for a regulatory arbitrage not permitted in the equities markets.[155] For example, an options market maker who sells short to hedge put options purchased by a market participant unable to locate

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[153] See letter from USANA; see also letter from Fairfax Financial (stating that the exception should be eliminated due to its "detrimental impact on issuers and their shareholders and also because such exception is susceptible to significant abuse").

[154] See 2007 Regulation SHO Final Amendments, 72 FR 45544; see also 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

[155] See Reproposal, 72 FR at 45563.

shares for a short sale in accordance with Rule 203(b)(2) of Regulation SHO may not have to close out any fails to deliver that result from such short sales under the options market maker exception. The ability of options market makers to sell short and never have to close out a resulting fail to deliver position, provided the short sale was effected to hedge options positions created before the security became a threshold security, runs counter to the goal of requiring that all fails to deliver in threshold securities be closed out.

IX. Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),[156] regarding the amendments to Regulation SHO, Rule 203, under the Exchange Act. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Reproposal. We solicited comments on the IRFA.

A. Reasons for and Objectives of the Amendments

The amendments to Rule 203(b)(3) of Regulation SHO are intended to further reduce the number of persistent fails to deliver in threshold securities by eliminating the options market maker exception to Regulation SHO's close-out requirement. As a result of the amendments, all fails to deliver in a threshold security resulting from short sales by a registered options market maker effected to establish or maintain a hedge on options positions established before the security became a threshold security will, like all other fails to deliver in threshold securities, have to be closed out in accordance with the close-out requirements of Regulation SHO.[157]

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[156] 5 U.S.C. 604.

[157] See 17 CFR 242.203(b)(3); see also Interim Final Temporary Rule, supra notes 42 and 43 (amending Regulation SHO to strengthen the delivery requirements for sales of all equity securities).

We are concerned that persistent, large fail positions may have a negative effect on the market in these securities. For example, although high fails levels exist only for a small percentage of issuers, they may impede the orderly functioning of the market for such issuers, particularly issuers of less liquid securities. A significant level of fails to deliver in a security may have adverse consequences for shareholders who may be relying on delivery of those shares for voting and lending purposes, or may otherwise affect an investor's decision to invest in that particular security. In addition, a seller that fails to deliver securities on trade settlement date effectively unilaterally converts a securities contract into an undated futures-type contract, to which the buyer might not have agreed, or that would have been priced differently. Moreover, sellers that fail to deliver securities on settlement date may enjoy fewer restrictions than if they were required to deliver the securities in a timely manner, and such sellers may attempt to use this additional freedom to engage in trading activities that deliberately depress the price of a security.

B. Significant Issues Raised by Public Comment

The IRFA appeared in the Reproposal. We requested comment on any aspect of the IRFA. In particular, we requested comment on: (i) the number of small entities that would be affected by the amendment; and (ii) the existence or nature of the potential impact of the amendments on small entities. We requested that the comments specify costs of compliance with the amendment, and suggest alternatives that would accomplish the objectives of the amendment. We did not receive any comments that responded specifically to this request.

C. Small Entities Subject to the Amendment

The entities covered by the amendments will include small entities that are participants of a registered clearing agency, including small registered options market makers for which the participant clears trades or for which it is responsible for settlement. In addition, the entities covered by these amendments will include small entities that are market participants that effect sales subject to the requirements of Regulation SHO. Most small entities subject to the amendments will be registered broker-dealers. Paragraph (c)(1) of Rule 0-10[158] 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 2007, the Commission estimates that there were approximately 896 registered broker-dealers that qualified as small entities as defined above.[159]

As noted above, the entities covered by the amendments will include small entities that are participants of a registered clearing agency. As of July 31, 2008, approximately 91% of participants of the NSCC, the primary registered clearing agency responsible for clearing U.S. transactions, were registered as broker-dealers. Participants not registered as broker-dealers include such entities as banks, U.S.-registered exchanges, and clearing agencies. Although these entities are participants of a registered clearing agency, generally these entities do not engage in the types of activities that would implicate the close-out requirements of Regulation SHO. Such activities of these entities include creating and redeeming Exchange Traded Funds, trading in municipal securities, and using NSCC's Envelope Settlement Service or Inter-city Envelope Settlement Service. These activities rarely lead to fails to deliver and, if fails to deliver do occur,

158 17 CFR 240.0-10(c)(1).

159 These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

they are small in number and are usually cleaned up within a day. Thus, such fails to deliver would not trigger the close-out provisions of Regulation SHO.

The federal securities laws do not define what is a "small business" or "small organization" when referring to a bank. The Small Business Administration regulations define "small entities" to include banks and savings associations with total assets of $165 million or less.[160] As of July 31, 2008, no bank that was a participant of the NSCC was a small entity because none met these criteria.

Paragraph (e) of Rule 0-10 under the Exchange Act[161] states that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (1) has been exempted from the reporting requirements of Rule 11Aa3-1 under the Exchange Act; and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0-10. No U.S. registered exchange is a small entity because none meets these criteria.

Paragraph (d) of Rule 0-10 under the Exchange Act[162] states that the term "small business" or "small organization," when referring to a clearing agency, means a clearing agency that: (1) compared, cleared and settled less than $500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter); (2) had less than $200 million in funds and securities in its custody or control at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and (3) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined

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160 See 13 CFR 121.201.

161 17 CFR 240.0-10(e).

162 17 CFR 240.0-10(d).

by Rule 0-10. No clearing agency that is subject to the requirements of Regulation SHO is a small entity because none meets these criteria.

D. Reporting, Recordkeeping, and other Compliance Requirements

The amendments to eliminate the options market maker exception to Regulation SHO's close-out requirement will impose minimal new or additional reporting, recordkeeping, or compliance costs on broker-dealers that are small entities. In order to comply with Regulation SHO when it became effective in January, 2005, entities needed to modify their systems and surveillance mechanisms. Thus, the infrastructure necessary to comply with the amendments to eliminate the options market maker exception should already be in place. Any additional changes to the infrastructure should be minimal. In addition, entities that will be subject to the mandatory close-out requirement of Rule 203(b)(3) of Regulation SHO should already have systems in place to close out non-excepted fails to deliver as required by Regulation SHO.

E. Agency Action to Minimize Effect on Small Entities

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, the Commission considered the following types of alternatives: (a) establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) clarification, consolidation, or simplification of compliance and reporting requirements under the amendments for small entities; (c) use of performance rather than design standards; and (d) an exemption from coverage of the amendment, or any part thereof, for small entities.

A primary goal of the amendments is to reduce the number of persistent fails to deliver in threshold securities. As such, we believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the goal of reducing fails to deliver. In addition, the rule amendment is already quite simple, so we do not believe it necessary to further clarify, consolidate or simplify the amendments for small entities. The Commission also believes that using performance standards to specify different requirements for small entities or exempting small entities from having to comply with the amendment would not accomplish the regulatory goal of adopting a consistent approach to persistent fails to deliver.

X. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 9(h), 10, 11A, 15, 17(a), 17A, and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78i(h), 78j, 78k-1, 78o, 78q(a), 78q-1, 78w(a), the Commission is adopting an amendment to §242.203.

List of Subjects in 17 CFR Part 241

Securities

List of Subjects in 17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

Text of the Amendments to Regulation SHO

For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows.

PART 241 – INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

1. Part 241 is amended by adding Release No. 34-58775 and the release date of October 14, 2008 to the list of interpretative releases.

PART 242 — REGULATIONS M, SHO, ATS, AC, AND NMS, AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

2. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

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3. Section 242.203 is amended by:

a. Revising paragraph (b)(3)(iii) and paragraph (b)(3)(v) to read as follows:

§ 242.203 Borrowing and delivery requirements.

* * * * *

(b) * * *

(3) * * *

(iii) Provided, however, that a participant of a registered clearing agency that has a fail to deliver position at a registered clearing agency in a threshold security on the effective date of this amendment and which, prior to the effective date of this amendment, had been previously excepted from the close-out requirement in paragraph (b)(3) of this section (i.e., because the participant of a registered clearing agency had a fail to deliver position in the threshold security that is attributed to short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the security became a threshold security), shall immediately close out that fail to deliver position, including any adjustments to the fail to deliver position, within 35 consecutive settlement days of the effective date of this amendment by purchasing securities of like kind and quantity;

* * * * *

(v) If a participant of a registered clearing agency entitled to rely on the 35 consecutive settlement day close-out requirement contained in paragraph (b)(3)(i), (b)(3)(ii), or (b)(3)(iii) of this section has a fail to deliver position at a registered clearing agency in the threshold security for 35 consecutive settlement days, the participant and any broker or dealer for which it clears transactions, including any market maker, that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(ii) of this section, may not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity;

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 14, 2008

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-58774; File No. S7-08-08]

RIN 3235-AK06

"Naked" Short Selling Antifraud Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting an antifraud rule under the Securities Exchange Act of 1934 ("Exchange Act") to address fails to deliver securities that have been associated with "naked" short selling. The rule will further evidence the liability of short sellers, including broker-dealers acting for their own accounts, who deceive specified persons about their intention or ability to deliver securities in time for settlement (including persons that deceive their broker-dealer about their locate source or ownership of shares) and that fail to deliver securities by settlement date.

DATES: Effective Date: October 17, 2008.

FOR FURTHER INFORMATION CONTACT: James A. Brigagliano, Associate Director, Josephine J. Tao, Assistant Director, Victoria L. Crane, Branch Chief, Joan M. Collopy, Special Counsel, Christina M. Adams and Matthew Sparkes, Staff Attorneys, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION: We are adding Rule 10b-21 [17 CFR 242.10b-21] under the Exchange Act.

I. Introduction

We are adopting an antifraud rule, Rule 10b-21, aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. Among other things, Rule 10b-21 will target short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[1] Rule 10b-21 will also apply to sellers who misrepresent to their broker-dealers that they own the shares being sold.

A seller misrepresenting its short sale locate source or ownership of shares may intend to fail to deliver securities in time for settlement and, therefore, engage in abusive "naked" short selling. Although abusive "naked" short selling is not defined in the federal securities laws, it refers generally to selling short without having stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement cycle.[2]

Although abusive "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b-5 of the Exchange Act,[3] Rule 10b-21 will further evidence the liability of persons that deceive others about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares.[4] We believe that a

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1 See 17 CFR 242.203(b)(1).

2 See Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544 (Aug. 14, 2007) ("2007 Regulation SHO Final Amendments"); Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006) ("2006 Regulation SHO Proposed Amendments").

3 17 CFR 240.10b-5.

4 This conduct is also in violation of other provisions of the federal securities laws, including the antifraud provisions.

rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. Rule 10b-21 will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have the right to expect prompt delivery of securities purchased. Thus, Rule 10b-21 takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. Rule 10b-21 will also aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, Rule 10b-21 could help reduce manipulative schemes involving "naked" short selling.

II. Background

A. Regulation SHO

Short selling involves a sale of a security that the seller does not own or that is consummated by the delivery of a security borrowed by or on behalf of the seller.[5] In a "naked" short sale, a seller does not borrow or arrange to borrow securities in time to make delivery to the buyer within the standard three-day settlement period.[6] As a result, the seller fails to deliver

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[5] 17 CFR 242.200(a).

[6] See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release") (stating that "naked" short selling generally refers to selling short without having borrowed the securities to make delivery).

securities to the buyer when delivery is due (known as a "fail" or "fail to deliver").[7] Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security,[8] or possibly to avoid borrowing costs associated with short sales.

Although the majority of trades settle within the standard three-day settlement period,[9] we adopted Regulation SHO[10] in part to address problems associated with persistent fails to

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[7] Generally, investors complete or settle their security transactions within three business days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when the investor purchases a security, the purchaser's payment generally is received by its brokerage firm no later than three business days after the trade is executed. When the investor sells a security, the seller generally delivers its securities, in certificated or electronic form, to its brokerage firm no later than three business days after the sale. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next business day following the trade. In addition, Rule 15c6-1 prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. 17 CFR 240.15c6-1; Exchange Act Release No. 33023 (Oct. 7, 1993), 58 FR 52891 (Oct. 13, 1993). However, failure to deliver securities on T+3 does not violate Rule 15c6-1.

[8] In 2003, the Commission settled a case against certain parties relating to allegations of manipulative short selling in the stock of a corporation. The Commission alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the stock, and depressed its price. See Rhino Advisors, Inc. and Thomas Badian, Lit. Rel. No. 18003 (Feb. 27, 2003); see also SEC v. Rhino Advisors, Inc. and Thomas Badian, Civ. Action No. 03-civ-1310 (RO) (S.D.N.Y) (Feb. 26, 2003); see also Securities Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) ("2003 Regulation SHO Proposing Release") (describing the alleged activity in the settled case involving stock of Sedona Corporation); 2004 Regulation SHO Adopting Release, 69 FR at 48016, n.76.

[9] According to the National Securities Clearing Corporation ("NSCC"), 99% (by dollar value) of all trades settle on time. Thus, on an average day, approximately 1% (by dollar value) of all trades, including equity, debt, and municipal securities fail to settle. The vast majority of these fails are closed out within five days after T+3. In addition, fails to deliver may arise from either short or long sales of securities. There may be legitimate reasons for a fail to deliver. For example, human or mechanical errors or processing delays can result from transferring securities in custodial or other form rather than book-entry form, thereby causing a fail to deliver on a long sale within the normal three-day settlement period. In addition, broker-dealers that make markets in a security ("market makers") and who sell short thinly-traded, illiquid stock in response to customer demand may encounter difficulty in obtaining securities when the time for delivery arrives. The Commission's Office of Economic Analysis ("OEA") estimates that, on an average day between May 1, 2007 and July 31, 2008 (i.e., the time period that includes all full months after the Commission started receiving price data from NSCC), trades in "threshold securities," as defined in Rule 203(b)(c)(6) of Regulation SHO, that fail to settle within T+3 account for approximately 0.3% of dollar value of trading in all equity securities.

[10] 17 CFR 242.200. Regulation SHO became effective on January 3, 2005.

deliver securities and potentially abusive "naked" short selling.[11] Rule 203 of Regulation SHO, in particular, contains a "locate" requirement that provides that, "[a] broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1)."[12] In the 2004 Regulation SHO Adopting Release, the Commission explicitly permitted broker-dealers to rely on customer assurances that the customer has identified its own source of borrowable securities, provided it is reasonable for the broker-dealer to do so.[13] We are concerned, however, that some short sellers may have been deliberately misrepresenting to broker-dealers that they have obtained a legitimate locate source.[14]

In addition, we are concerned that some short sellers may have made misrepresentations to their broker-dealers about their ownership of shares as an end run around Regulation SHO's locate requirement.[15] Some sellers have also misrepresented that their sales are long sales in order to circumvent Rule 105 of Regulation M,[16] which prohibits certain short sellers from

[11] See 2007 Regulation SHO Final Amendments, 72 FR at 45544 (stating that "[a]mong other things, Regulation SHO imposes a close-out requirement to address persistent failures to deliver stock on trade settlement date and to target potentially abusive "naked" short selling in certain equity securities.").

[12] 17 CFR 242.203(b). Market makers engaged in bona fide market making in the security at the time they effect the short sale are excepted from this requirement.

[13] See 2004 Regulation SHO Adopting Release, 69 FR at 48014.

[14] See, e.g., Sandell Asset Management Corp., Lars Eric Thomas Sandell, Patrick T. Burke and Richard F. Ecklord, Securities Act Release No. 8857 (Oct. 10, 2007) (settled order).

[15] See id.

[16] 17 CFR 242.105.

purchasing securities in a secondary or follow-on offering.[17] Under Rule 200(g)(1) of Regulation SHO, "[a]n order to sell shall be marked 'long' only if the seller is deemed to own the security being sold pursuant to paragraphs (a) through (f) of this section[18] and either: (i) the security to be delivered is in the physical possession or control of the broker or dealer; or (ii) it is reasonably expected that the security will be in the physical possession or control of the broker or dealer no later than the settlement of the transaction."[19]

Under Regulation SHO, the executing or introducing broker-dealer is responsible for determining whether there are reasonable grounds to believe that a security can be borrowed so that it can be delivered on the date delivery is due on a short sale, and whether a seller owns the security being sold and can reasonably expect that the security will be in the physical possession or control of the broker-dealer no later than settlement date for a long sale. However, a broker-dealer relying on a customer that makes misrepresentations about its locate source or ownership of shares may not receive shares when delivery is due. For example, sellers may be making misrepresentations to their broker-dealers about their locate sources or ownership of shares for securities that are very difficult or expensive to borrow. Such sellers may know that they cannot deliver securities by settlement date due to, for example, a limited number of shares being available to borrow or purchase, or they may not intend to obtain shares for timely delivery

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17 See Goldman Sachs Execution and Clearing L.P.; Exchange Act Release No. 55465 (Mar. 14, 2007) (settled order); Weitz and Altman, Lit. Release No. 18121 (April 30, 2003) (settled civil action).

18 Rule 200(b) of Regulation SHO provides that a seller is deemed to own a security if, "(1) The person or his agent has title to it; or (2) The person has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it, but has not yet received it; or (3) The person owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) The person has an option to purchase or acquire it and has exercised such option; or (5) The person has rights or warrants to subscribe to it and has exercised such rights or warrants; or (6) The person holds a security futures contract to purchase it and has received notice that the position will be physically settled and is irrevocably bound to receive the underlying security."

19 17 CFR 242.200(g)(1).

because the cost of borrowing or purchasing may be high. That result undermines the Commission's goal of addressing concerns related to "naked" short selling and extended fails to deliver.

B. Concerns about "Naked" Short Selling

We have been concerned about "naked" short selling and, in particular, abusive "naked" short selling, for some time. As discussed above, our concerns about potentially abusive "naked" short selling were an important reason for our adoption of Regulation SHO in 2004. In addition, due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continued to observe a small number of threshold securities[20] with fail to deliver positions that were not being closed out under existing delivery and settlement requirements, in 2007 we eliminated the "grandfather" exception to Regulation SHO's close-out requirement[21] and today we adopted amendments to eliminate the options market maker exception to the close-out requirement.[22]

In addition to the actions we have taken aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling in threshold securities, recently we took emergency

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20 A "threshold security" is defined in Rule 203(c)(6) as any equity security of an issuer that is registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act (15 U.S.C. 78o(d)): (i) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding; and (ii) that is included on a list disseminated to its members by a self-regulatory organization. 17 CFR 242.203(c)(6).

21 See 2007 Regulation SHO Final Amendments, 72 FR 45544. The "grandfather" exception had provided that fails to deliver established prior to a security becoming a threshold security did not have to be closed out in accordance with Regulation SHO's close-out requirement. This amendment also contained a one-time phase-in period that provided that previously-grandfathered fails to deliver in a security that was a threshold security on the effective date of the amendment must be closed out within 35 consecutive settlement days from the effective date of the amendment. The phase-in period ended December 5, 2007.

22 See Exchange Act Release No. 34-58775 (Oct. 14, 2008) ("2008 Regulation SHO Final Amendments"). The options market maker exception had excepted from the close-out requirement any fail to deliver position in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security.

action targeting "naked" short selling in some non-threshold securities. Specifically, on July 15, 2008, we published an emergency order under Section 12(k) of the Exchange Act (the "July Emergency Order")[23] that temporarily imposed enhanced requirements on short sales in the publicly traded securities of certain substantial financial firms.[24]

We issued the July Emergency Order because we were concerned that false rumors spread by short sellers regarding financial institutions of significance in the U.S. could continue to threaten significant market disruption. As we noted in the July Emergency Order, false rumors can lead to a loss of confidence in our markets. Such loss of confidence can lead to panic selling, which may be further exacerbated by "naked" short selling. As a result, the prices of securities may artificially and unnecessarily decline well below the price level that would have resulted from the normal price discovery process. If significant financial institutions are involved, this chain of events can threaten disruption of our markets.[25]

On July 29, 2008, we extended the July Emergency Order after carefully reevaluating the current state of the markets in consultation with officials of the Board of Governors of the Federal Reserve System, the Department of the Treasury, and the Federal Reserve Bank of New

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23 See Exchange Act Release No. 58166 (July 15, 2008).

24 See id. The Emergency Order required that, in connection with transactions in the publicly traded securities of the substantial financial firms identified on Appendix A to the Emergency Order ("Appendix A Securities"), no person could effect a short sale in the Appendix A Securities using the means or instrumentalities of interstate commerce unless such person or its agent had borrowed or arranged to borrow the security or otherwise had the security available to borrow in its inventory prior to effecting such short sale and delivered the security on settlement date.

25 We delayed the effective date of the Emergency Order to July 21, 2008 to create the opportunity to address, and to allow sufficient time for market participants to make, adjustments to their operations to implement the enhanced requirements. Moreover, in addressing anticipated operational accommodations necessary for implementation of the Emergency Order, we issued an amendment to the Emergency Order on July 18, 2008. See Exchange Act Release No. 58190 (July 18, 2008) (excepting from the Emergency Order bona fide market makers, short sales in Appendix A Securities sold pursuant to Rule 144 of the Securities Act of 1933, and certain short sales by underwriters, or members of a syndicate or group participating in distributions of Appendix A Securities).

York. Due to our continued concerns about the ongoing threat of market disruption and effects on investor confidence, we determined that the standards of extension had been met.[26] Pursuant to the extension, the July Emergency Order terminated at 11:59 p.m. EDT on August 12, 2008.[27]

In addition to our adopting Rule 10b-21, as noted above, today we also adopted amendments to eliminate the options market maker exception to Regulation SHO's delivery requirement.[28] We also adopted today an interim final temporary rule that enhances the delivery requirements for sales of all equity securities ("2008 Interim Rule").[29]

The amendments to the options market maker exception and the 2008 Interim Rule that we adopted today both focus on the timely delivery of securities and are not aimed at pre-trade activity, such as compliance with Regulation SHO's locate requirement. Because we continue to be concerned about fails to deliver and potentially abusive "naked" short selling, in addition to our initiatives to strengthen Regulation SHO's delivery requirements, we are adopting Rule 10b-21 to also target sellers who deceive their broker-dealers or certain other persons about their source of borrowable shares and their share ownership.

As we stated in the Proposing Release,[30] we are concerned about persons that sell short securities and deceive specified persons about their intention or ability to deliver the securities in time for settlement, or deceive their broker-dealer about their locate source or ownership of

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26 See Exchange Act Release No. 58248 (July 29, 2008).

27 In addition, on September 17, 2008, the Commission further addressed abusive "naked" short selling by issuing an Emergency Order that temporarily adopted amendments to Regulation SHO's close-out requirement, amendments to eliminate Regulation SHO's options market maker exception to the close-out requirement, and Rule 10b-21. See Exchange Act Release No. 58572 (Sept. 17, 2008). The Commission also issued emergency orders to require disclosure of short sales, Exchange Act Release 58591 (Sept. 18, 2008) and 58591A (Sept. 21, 2008), and temporarily halt short selling in financial stocks, Exchange Act Release 58592 (Sept. 18, 2008) and Exchange Act Release 58611 (Sept. 21, 2008).

28 See supra note 22.

29 See Exchange Act Release No. 58773 (Oct. 14, 2008).

30 Exchange Act Release No. 57511 (Mar. 17, 2008), 73 FR 15376, 15377 (Mar. 21, 2008) ("Proposing Release").

shares. Commission enforcement actions have contributed to our concerns about the extent of misrepresentations by short sellers about their locate sources and ownership of shares, regardless of whether they result in fails to deliver. For example, the Commission recently announced a settled enforcement action against hedge fund adviser Sandell Asset Management Corp. ("SAM"), its chief executive officer, and two employees in connection with allegedly (i) improperly marking some short sale orders "long" and (ii) misrepresenting to executing brokers that SAM personnel had located sufficient stock to borrow for short sale orders.[31]

In addition, as we have stated on several prior occasions, we are concerned about the negative effect that fails to deliver may have on the markets and shareholders.[32] For example, fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.[33] In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.[34]

In addition, commenters (including issuers and investors) have repeatedly expressed concerns about fails to deliver in connection with manipulative "naked" short selling. For

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[31] See Sandell Asset Management Corp., Securities Act Release No. 8857; see also Goldman Sachs Execution and Clearing L.P., Exchange Act Release No. 55465; U.S. v. Naftalin, 441 U.S. 768 (1979) (discussing a market manipulation scheme in which brokers suffered substantial losses when they had to purchase securities to replace securities they had borrowed to make delivery on short sale orders received from an individual investor who had falsely represented to the brokers that he owned the securities being sold).

[32] See supra note 22 ; 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Proposing Release, 73 FR at 15378.

[33] See id.

[34] See id.

example, in response to proposed amendments to Regulation SHO in 2006[35] designed to further reduce the number of persistent fails to deliver in certain equity securities by eliminating Regulation SHO's "grandfather" exception, and amending the options market maker exception, we received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[36] Commenters continued to express these concerns in response to proposed amendments to eliminate the options market maker exception to the close-out requirement of Regulation SHO in 2007[37] and in response to the Proposing Release.[38]

To the extent that fails to deliver might be part of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[39] such fails to deliver may

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35 See 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

36 See, e.g., letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Sept. 11, 2006 ("Overstock"); letter from Daniel Behrendt, Chief Financial Officer, and Douglas Klint, General Counsel, TASER International, dated Sept. 18, 2006 ("TASER"); letter from John Royce, dated April 30, 2007 ("Royce"); letter from Michael Read, dated April 29, 2007 ("Read"); letter from Robert DeVivo, dated April 26, 2007 ("DeVivo"); letter from Ahmed Akhtar, dated April 26, 2007 ("Akhtar").

37 See, e.g., letter from Jack M. Wedam, dated Oct. 16, 2007; letter from Michael J. Ryan, Executive Director and Senior Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated Sept. 13, 2007 ("U.S. Chamber of Commerce"); letter from Robert W. Raybould, CEO Enteleke Capital Corp., dated Sept. 12, 2007; letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 11, 2007 ("NCANS 2007").

38 See, e.g., letter from Richard H. Baker, President and Chief Executive Officer, Managed Funds Association, dated May 21, 2008 ("MFA") (stating that "[m]arket manipulation, such as intentional and abusive naked short selling, undermines the integrity of the U.S. capital markets and threatens investor confidence, market liquidity and market efficiency"); letter from Kurt N. Schacht and Linda Rittenhouse, Centre for Financial Market Integrity, dated June 17, 2008 (stating that they "support efforts by the Commission to curtail naked short selling, for all the reasons noted in the [Proposing Release] relating to the detrimental effects on the marketplace. As noted [in the Proposing Release], this practice not only affects shareowners by depriving the[m] of the basic benefits of ownership, it also may detrimentally affect the issuer's reputation and subvert the appropriate workings of the market by avoiding certain restrictions applicable to those who deliver on time. All of these issues can ultimately undermine investor confidence."); letter from Wallace E. Boston, President and Chief Executive Officer, American Public Education, Inc., dated May 20, 2008 (noting that "[a]s the CEO of a recently public company, I am acutely aware of the impact that abusive short-selling can have on issuers and investors.").

39 See, e.g., Rhino Advisors, Inc. and Thomas Badian, Lit. Rel. No. 18003 (Feb. 27, 2003); see also SEC v. Rhino Advisors, Inc. and Thomas Badian, Civ. Action No. 03 civ 1310 (RO) (S.D.N.Y) (Feb. 26, 2003) (settled case in which we alleged that the defendants profited from engaging in massive "naked" short selling that flooded the market with the company's stock, and depressed its price); see also S.E.C. v. Gardiner, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. 1991) (alleged manipulation by sales representative by directing or inducing

undermine the confidence of investors.[40] These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.[41] In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[42] Unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[43]

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customers to sell stock short in order to depress its price); U.S. v. Russo, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b–5).

40 In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters discussing the impact of fails to deliver on investor confidence. See, e.g., letter from NCANS 2007. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 30, 2006 ("NCANS 2006"); letter from Richard Blumenthal, Attorney General, State of Connecticut, dated Sept. 19, 2006.

41 In response to the 2007 Regulation SHO Proposed Amendments, we received comment letters expressing concern about the impact of potential "naked" short selling on capital formation, claiming that "naked" short selling causes a drop in an issuer's stock price and may limit the issuer's ability to access the capital markets. See, e.g., letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007; letter from NCANS 2007. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Congressman Tom Feeney - Florida, U.S. House of Representatives, dated Sept. 25, 2006; see also letter from Zix Corporation, dated Sept. 19, 2006 (stating that "[m]any investors attribute the Company's frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company "do something" about the perceived manipulative short selling. This perception that manipulative short selling of the Company's securities is continually occurring has undermined the confidence of many of the Company's investors in the integrity of the market for the Company's securities.").

42 Due in part to such concerns, some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company ("DTC") or broker-dealers. See 2003 Regulation SHO Proposing Release, 68 FR at 62975. Some issuers have attempted to withdraw their issued securities on deposit at DTC, which makes the securities ineligible for book-entry transfer at a securities depository. See id. Withdrawing securities from DTC or requiring custody-only transfers would undermine the goal of a national clearance and settlement system designed to reduce the physical movement of certificates in the trading markets. See id. We note, however, that in 2003 the Commission approved a DTC rule change clarifying that its rules provide that only its participants may withdraw securities from their accounts at DTC, and establishing a procedure to process issuer withdrawal requests. See Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037 (June 11, 2003).

43 See also 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Amendments, 72 FR at 45544; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Proposing Release, 73 FR at 15378 (providing additional discussion of the impact of fails to deliver on the market); see also 2003 Regulation SHO Proposing Release, 68 FR at 62975 (discussing the impact of "naked" short selling on the market).

Strengthening rules that address "naked" short selling will provide increased confidence in the markets. Since the issuance of the July Emergency Order, members of the public have repeatedly expressed their concerns about a loss of confidence in the markets. For example, one commenter stated that "financial confidence is critically important" for companies to do business.[44] Another commenter stated that "existing laws should be enforced, but further steps should be taken to prevent any further erosion of the investing publics [sic] confidence."[45]

We are concerned about the ability of short sellers to use "naked" short selling as a tool to manipulate the prices of securities.[46] Thus, in conjunction with our other short selling initiatives aimed at further reducing fails to deliver and addressing abusive "naked" short selling, we have adopted Rule 10b-21 substantially as proposed.

Proposed Rule 10b-21 was narrowly tailored to specify that it is unlawful for any person to submit an order to sell a security if such person deceives a broker-dealer, participant of a registered clearing agency,[47] or purchaser regarding its intention or ability to deliver the security

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44 See Comment of Ron Heller (July 21, 2008) ("Heller") (commenting on the Emergency Order).

45 See Comment of Ronald L. Rourk (July 21, 2008) ("Rourk") (commenting on the proposal to eliminate Regulation SHO's options market maker exception).

46 See, e.g., Commission press release, dated July 13, 2008, announcing that the Commission's Office of Compliance Inspections and Examinations, as well as FINRA and New York Stock Exchange Regulation, Inc., will immediately conduct examinations aimed at the prevention of the intentional spreading of false information intended to manipulate securities prices. See http://www.sec.gov/news/press/2008/2008-140.htm. In addition, in April of this year, the Commission charged Paul S. Berliner, a trader, with securities fraud and market manipulation for intentionally disseminating a false rumor concerning The Blackstone Group's acquisition of Alliance Data Systems Corp ("ADS"). The Commission alleged that this false rumor caused the price of ADS stock to plummet, and that Berliner profited by short selling ADS stock and covering those sales as the false rumor caused the price of ADS stock to fall. See http://www.sec.gov/litigation/litreleases/2008/lr20537.htm.

47 The term "participant" has the same meaning as in section 3(a)(24) of the Exchange Act. See 15 U.S.C. 78c(a)(24). The term "registered clearing agency" means a clearing agency, as defined in section 3(a)(23) of the Exchange Act, that is registered as such pursuant to section 17A of the Exchange Act. See 15 U.S.C. 78c(a)(23)(A), 78q-1 and 15 U.S.C. 78q-1(b), respectively.

on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due.[48] We received over 700 comment letters in response to the Proposing Release.

The comment letters were from numerous entities, including issuers, retail investors, broker-dealers, SROs, associations, members of Congress, and other elected officials.[49] Many commenters supported our goals of further addressing potentially abusive "naked" short selling and fails to deliver, while not necessarily agreeing with the Commission's approach. For example, some commenters argued for more stringent short sale regulation.[50] Others urged us to take stronger enforcement action against abusive "naked" short sellers under the current federal securities laws rather than, or in addition to, adopting Rule 10b-21.[51] Some commenters asked that if we adopt Rule 10b-21 as proposed, we provide certain clarifications regarding the application of the rule.[52] We highlight in the discussion below some of the main issues, concerns, and suggestions raised in the comment letters.

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48 See Proposed Rule 10b-21.

49 The comment letters are available on the Commission's Internet Web Site at http://www.sec.gov/comments/s7-08-08/s70808.shtml.

50 See, e.g., letter from Arik B. Fetscher, Esq., dated April 2, 2008; letter from Fred Adams, Jr., Chairman and Chief Executive Officer, Cal-Maine Foods, Inc., dated May 19, 2008; letter from David T. Hirschman, President and Chief Executive Officer, Center for Capital Markets Competitiveness, United States Chamber of Commerce, dated May 20, 2008 ("Chamber of Commerce"); letter from Wallace E. Boston, Jr., President and Chief Executive Officer, American Public Education, Inc., dated May 20, 2008; letter from Kurt N. Schacht, Executive Director, and Linda L. Rittenhouse, Senior Policy Analyst, CFA Institute Centre for Financial Market Integrity, dated June 17, 2008; letter from Guillaume Cloutier, dated July 25, 2008; letter from Shunliang Wang, dated July 27, 2008; letter from Scott Bridgford, dated July 29, 2008; letter from Keith Kottwitz, dated Aug. 1, 2008.

51 See, e.g., letter from Tony J. Akin, Jr., Financial Advisor, dated March 31, 2008; letter from Gary D. Owens, CEO, OYO Geospace, dated April 22, 2008; letter from Daniel J. Popeo, Chairman & General Counsel, and Paul D. Kamenar, Senior Executive Counsel, Washington Legal Foundation, dated May 20, 2008; letter from David Hughes, dated July 17, 2008.; letter from Dave Morgan, dated July 25, 2008; letter from Seth Bradley, dated July 30, 2008; letter from Michael Kianka, dated Aug. 1, 2008.

52 See, e.g., letter from James J. Angel, Associate Professor of Finance, Georgetown University, dated May 17, 2008 ("Angel"); letter from Heather Traeger, Assistant Counsel, Investment Company Institute, dated May 20, 2008; letter from Dr. Robert J. Shapiro, Chairman, Sonecon, LLC, and former U.S. Under Secretary of Commerce, dated May 20, 2008 ("Shapiro"); letter from Ira D. Hammerman, Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated May 22, 2008

III. Discussion of Rule 10b-21

A. Rule 10b-21

After careful consideration of the comments, we are adopting Rule 10b-21 substantially as proposed. Rule 10b-21 specifies that it is unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency,[53] or purchaser regarding its intention or ability to deliver the security on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due.[54] Scienter is a necessary element for a violation of the rule.[55] Some commenters questioned whether, similar to Regulation SHO, proposed Rule 10b-21 would apply only to equity securities.[56] In response to these comments, we clarify that as proposed and adopted, Rule 10b-21 applies only to equity securities.[57]

Rule 10b-21 will cover those situations where a seller deceives a broker-dealer, participant of a registered clearing agency, or a purchaser about its intention to deliver securities

("SIFMA"); letter from Michael R. Trocchio, Bingham McCutchen LLP, dated July 14, 2008 ("Bingham"); letter from MFA.

53 See supra note 47 (defining the terms "participant" and "registered clearing agency" for purposes of the rule).

54 See Rule 10b-21.

55 Ernst & Ernst v. Hochfelder, et. al., 425 U.S. 185 (1976). Scienter has been defined as "a mental state embracing the intent to deceive, manipulate or defraud." Id. at 193, n.12. While the Supreme Court has not decided the issue (see Aaron v. SEC, 446 U.S. 686 (1980); Ernst & Ernst, 425 at 193 n.12), federal appellate courts have concluded that scienter may be established by a showing of either knowing conduct or by "an 'extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" Dolphin & Bradbury v. SEC, 512 F.3d 634 (D.C. Cir. Jan. 11, 2008) (quoting Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977)). Some commenters stated they believe that Rule 10b-21 should require a finding of "intentional deception" to best achieve our goals without deterring legitimate short selling. See, e.g., letter from MFA; another commenter, however, requested that we confirm that the concept of scienter, for purposes of Rule 10b-21, is identical to established precedent under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. See letter from SIFMA. We intend the scienter requirement of Rule 10b-21 to be the same as that required under Rule 10b-5.

56 See, e.g., letter from MFA.

57 See, e.g., Proposing Release, 73 FR at 15380; see also Rule 10b-21.

by settlement date, its locate source, or its share ownership, and the seller fails to deliver securities by settlement date.[58] Rule 10b-21 will prohibit the deception of persons participating in the transaction – broker-dealers, participants of registered clearing agencies, or purchasers. Further, because one of the principal goals of Rule 10b-21 is to reduce fails to deliver, violation of the rule will occur only if a fail to deliver results from the relevant transaction.

For purposes of Rule 10b-21, broker-dealers (including market makers) acting for their own accounts will be considered sellers. For example, a broker-dealer effecting short sales for its own account will be liable under the rule if it does not obtain a valid locate source and fails to deliver securities to the purchaser. Such broker-dealers defraud purchasers that may not receive delivery on time, in effect unilaterally forcing the purchaser into accepting an undated futures-type contract.[59]

As noted above, under Regulation SHO, the executing or introducing broker-dealer is responsible for determining whether there are reasonable grounds to believe that a security can be borrowed so that it can be delivered on the date delivery is due on a short sale.[60] In the 2004 Regulation SHO Adopting Release, the Commission explicitly permitted broker-dealers to rely on customer assurances that the customer has identified its own locate source, provided it is reasonable for the broker-dealer to do so.[61] If a seller elects to provide its own locate source to a broker-dealer, the seller is representing that it has contacted that source and reasonably believes

[58] As proposed, the rule referenced "the date delivery is due." To provide specificity as to when delivery is due for purposes of the rule, we are modifying this language to "settlement date" and defining "settlement date" as "the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security." See Rule 10b-21(b).

[59] See supra note 22; 2007 Regulation SHO Final Amendments, 72 FR at 45544; 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559.

[60] See 17 CFR 242.203(b)(3)(1).

[61] See 2004 Regulation SHO Adopting Release, 69 FR at 48014.

that the source can or intends to deliver the full amount of the securities to be sold short by settlement date. In addition, if a seller enters a short sale order into a broker-dealer's direct market access or sponsored access system ("DMA") with any information purporting to identify a locate source obtained by the seller, the seller makes a representation to a broker-dealer for purposes of Rule 10b-21.[62]

If a seller deceives a broker-dealer about the validity of its locate source, the seller will be liable under Rule 10b-21 if the seller also fails to deliver securities by the date delivery is due. For example, a seller will be liable for a violation of Rule 10b-21 if it represented that it had identified a source of borrowable securities, but the seller never contacted the purported source to determine whether shares were available and could be delivered in time for settlement and the seller fails to deliver securities by settlement date. A seller will also be liable if it contacted the source and learned that the source did not have sufficient shares for timely delivery, but the seller misrepresented that the source had sufficient shares that it could deliver in time for settlement and the seller fails to deliver securities by settlement date; or, if the seller contacted the source and the source had sufficient shares that it could deliver in time for settlement, but the seller never instructed the source to deliver the shares in time for settlement and the seller otherwise refused to deliver shares on settlement date such that the sale results in a fail to deliver.

One commenter recommended that the rule focus on whether there is a fail to deliver in the Continuous Net Settlement ("CNS") system, rather than on a seller's failure to deliver the securities sold.[63] The majority of equity trades in the United States are cleared and settled

62 Broker-dealers offer DMA to some customers by providing them with electronic access to a market's execution system using the broker-dealer's market participant identifier. The broker-dealer, however, retains the ultimate responsibility for the trading activity of its customer.

63 <u>See</u> letter from SIFMA.

through systems administered by clearing agencies registered with the Commission. The NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over the counter market. NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. The majority of NSCC's members are broker-dealers.[64] NSCC notifies its members of their securities delivery and payment obligations daily. In addition, NSCC guarantees the completion of all transactions and interposes itself as the contraparty to both sides of the transaction. This commenter noted that a seller's clearing broker generally bears the responsibility to meet the firm's CNS delivery requirement and that it is difficult for a broker-dealer to determine which customer transactions or accounts give rise to a fail to deliver in the CNS system. We note, however, that Rule 10b-21 as proposed was not based on whether a fail to deliver occurred in CNS. Rather, the rule as proposed was concerned with whether an individual seller delivered securities that it sold. Along those lines, another commenter stated that the proposed rule should require a failure to deliver by the seller.[65]

We have determined to adopt the rule as proposed. The rule targets the misconduct of sellers. As discussed above, sellers should promptly deliver the securities they have sold and purchasers have the right to the timely receipt of securities that they have purchased. Thus, Rule 10b-21's focus is on whether or not there is a fail to deliver by the seller, rather than on whether or not there is a fail to deliver in the CNS system. Because fails to deliver in the CNS system are netted with pending deliveries, some sellers may be able to postpone delivery if another customer's purchase is received the same day. Thus, a person engaging in abusive "naked" short

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[64] As of July 31, 2008 approximately 91% of members of the NSCC were registered as broker-dealers.

[65] See letter from Bingham.

selling may be able to avoid detection for a period of time. This would undermine our goal of addressing abusive "naked" short selling.

B. Seller's Reliance on a Broker-Dealer or "Easy to Borrow" Lists

Rule 10b-21 provides that it shall be unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser regarding its intention or ability to deliver the security on the date delivery is due.[66] Thus, as we discussed in the Proposing Release,[67] if a seller is relying on a broker-dealer to comply with Regulation SHO's locate obligation and to make delivery on a sale, the seller would not be representing at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due. For example, a seller might be relying on its broker-dealer to borrow or arrange to borrow the security to make delivery by settlement date. Alternatively, a seller might be relying on a broker-dealer's "Easy to Borrow" list. If a seller in good faith relies on a broker-dealer's "Easy to Borrow" list to satisfy the locate requirement, the seller would not be deceiving the broker-dealer at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due. In discussing the locate requirement of Regulation SHO, in the 2004 Regulation SHO Adopting Release, the Commission stated that "absent countervailing factors, 'Easy to Borrow' lists may provide 'reasonable grounds' for a broker-dealer to believe that the security sold short is available for borrowing without directly contacting the source of the borrowed securities."[68]

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[66] See Rule 10b-21.

[67] See Proposing Release, 73 FR at 15379.

[68] 2004 Regulation SHO Adopting Release, 69 FR at 48014.

C. Bona Fide Market Makers

As we discussed in the Proposing Release,[69] a market maker engaged in bona fide market making activity would not be making a representation at the time it submits an order to sell short that it can or intends to deliver securities on the date delivery is due, because such market makers are excepted from the locate requirement of Regulation SHO. Regulation SHO excepts from the locate requirement market makers engaged in bona-fide market making activities because market makers need to facilitate customer orders in a fast moving market without possible delays associated with complying with the locate requirement.[70] Thus, at the time of submitting an order to sell short, market makers that have an exception from the locate requirement of Regulation SHO may know that they may not be able to deliver securities on the date delivery is due.

D. "Long" Sales

Under Rule 10b-21, a seller will be liable if it deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its ownership of shares or the deliverable condition of owned shares and fails to deliver securities by settlement date.[71] As we discussed in the Proposing Release,[72] a seller will be liable for a violation of Rule 10b-21 for causing a broker-dealer to mark an order to sell a security "long" if the seller knows or recklessly disregards that it is not "deemed to own" the security being sold, as defined in Rules 200(a)

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69 See Proposing Release, 73 FR at 15379.

70 See 2004 Regulation SHO Adopting Release, 69 FR at 48015, n. 67; see also 2008 Regulation SHO Final Amendments, supra note 22 (providing interpretive guidance regarding bona fide market making activities for purposes of Regulation SHO).

71 See Rule 10b-21.

72 See Proposing Release, 73 FR at 15379.

through (f) of Regulation SHO[73] or if the seller knows or recklessly disregards that the security being sold is not, or cannot reasonably be expected to be, in the broker-dealer's physical possession or control by the date delivery is due, and the seller fails to deliver the security by settlement date.

Broker-dealers acting for their own accounts will also be liable under Rule 10b-21 for marking an order "long" if the broker-dealer knows or recklessly disregards that it is not "deemed to own" the security being sold or that the security being sold is not, or cannot reasonably be expected to be, in the broker-dealer's physical possession or control by the date delivery is due, and the broker-dealer fails to deliver the security by settlement date.[74]

However, a seller would not be making a representation at the time it submits an order to sell a security that it can or intends to deliver securities on the date delivery is due if the seller submits an order to sell securities that are held in a margin account but the broker-dealer has loaned out the shares pursuant to the margin agreement. Under such circumstances, it would be reasonable for the seller to expect that the securities will be in the broker-dealer's physical possession or control by settlement date.

E. Rule 10b-21 and Other Antifraud Provisions of the Federal Securities Laws

One commenter stated that it believes proposed Rule 10b-21 is unnecessary "because the Commission already has ample existing authority, under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, to prosecute manipulative and/or fraudulent activity, including the type of activity that proposed Rule 10b-21 seeks to address."[75] Other commenters urged us to use less

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[73] 17 CFR 242.200(a)-(f).

[74] Such broker-dealers will also be liable under Regulation SHO Rule 203(a).

[75] See letter from SIFMA; see also letter from Bingham (stating that "[t]he Firms agree that the illicit conduct the Commission seeks to address through [proposed Rule 10b-21] is already illegal"); letter from MFA.

formal means than rulemaking to address our concerns regarding misrepresentations in the order entry process.[76] For instance, these commenters suggested that the Commission or its staff could convey this message through FAQs, staff bulletins, and speeches.[77] We have determined, however, that the negative effects of abusive "naked" short selling on market confidence warrant formal Commission action.

While "naked" short selling as part of a manipulative scheme is already illegal under the general antifraud provisions of the federal securities laws, we believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. Rule 10b-21 will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

Some commenters sought clarification as to how this rule was different from Rule 10b-5.[78] We note that the set of factors that will serve as the basis for a violation of Rule 10b-21 as adopted are not determinative of a person's obligations under the general antifraud provisions of the federal securities laws. Accordingly, and in order to clarify the continued applicability of the general antifraud provisions outside of the strict context of Rule 10b-21, we have added a preliminary note to the rule as adopted, which states: "This rule is not intended to limit, or restrict, the applicability of the general antifraud provisions of the federal securities laws, such as section 10(b) of the Act and rule 10b-5 thereunder." We added this preliminary

76 See, e.g., letter from Bingham; letter from MFA; but, c.f., letter from Chamber of Commerce (noting that although the activity covered by proposed Rule 10b-21 is already a violation of the antifraud provisions of the federal securities laws, "[e]mphasizing that such deceit violates these laws may deter some of this activity in the future").

77 See, e.g., letter from Bingham.

78 See, e.g., letter from MFA; see also letter from SIFMA (seeking clarification as to whether the level of scienter in the proposed rule differs from that of Rule 10b-5).

note because we believe it is important to underscore that Rule 10b-21 is not meant, in any way, to limit the general antifraud provisions of the federal securities laws. Additionally, this preliminary note provides much needed public clarity in answer to the confusion voiced by many commenters.

Similarly, we are modifying the proposed rule text slightly to add the word "also," as follows: "It shall also constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of this Act for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date."

We believe the adding the word "also" in the rule text further clarifies that Rule 10b-21 does not affect the operation of Rule 10b-5 or other antifraud rules, but is instead intended to supplement the existing antifraud rules.

Commenters also raised questions whether there would be a private right of action for a violation of proposed Rule 10b-21.[79] We note that the courts have held that a private right of action exists with respect to Rule 10b-5 provided the essential elements constituting a violation of the rule are met.[80] Thus, a private plaintiff able to prove all those elements in a situation covered by Rule 10b-21 would be able to assert a claim under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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[79] See, e.g., letter from SIFMA. Another commenter stated that "[t]he Commission should make explicitly clear that the adoption of Proposed Rule 10b-21 does not create a private right of action for violations of the rule . . . ." See letter from Bingham.

[80] See, e.g., Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 13, n. 9 (1971); Ernst & Ernst, 425 at 196 (citing prior cases).

F. Aiding and Abetting Liability

In the proposing release, we stated that "[a]lthough the proposed rule is primarily aimed at sellers that deceive specified persons about their intention or ability to deliver shares or about their locate source and ownership of shares, as with any rule, broker-dealers could be liable for aiding and abetting a customer's fraud under the proposed rule."[81] One commenter stated that broker-dealers should not be held responsible for policing their customer's compliance with their own legal requirements.[82] Another commenter urged us to specifically state that reliance by a broker-dealer on a customer representation regarding long/short status or receipt of a locate does not rise to the level of scienter required for aiding and abetting liability.[83] This commenter also asked us to make clear that broker-dealers who merely offer DMA or sponsored access to a customer who violates the new rule would not be liable for aiding and abetting such violation.[84]

Rule 10b-21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. As we stated in the Proposing Release, broker-dealers would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws.[85]

G. Administrative Law Matters

The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[86] This requirement,

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[81] See Proposing Release, 72 FR at 15379.

[82] See letter from SIFMA.

[83] See letter from Bingham.

[84] See id.

[85] See Proposing Release, 72 FR at 15380.

[86] See 5 U.S.C. §553(d).

however, does not apply if the agency finds good cause for making the rule effective sooner.[87] The Commission has determined that the rule should be effective in fewer than 30 days because it addresses illegal conduct that can cause market disruption. In addition, because the rule further evidences conduct that is manipulative and deceptive under existing general antifraud rules, market participants should not need time to adjust systems or procedures to comply with the rule. Therefore, the Commission finds good cause to make the rule effective on October 17, 2008.

IV. Paperwork Reduction Act

Rule 10b-21 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[88]

V. Cost-Benefit Analysis

We are sensitive to the costs and benefits of our rules and we have considered the costs and benefits of Rule 10b-21. In order to assist us in evaluating the costs and benefits, in the Proposing Release, we encouraged commenters to discuss any costs or benefits that the rule would impose. In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the rule for issuers, investors, brokers or dealers, other securities industry professionals, regulators, and other market participants. Commenters were encouraged to provide analysis and data to support their views on the costs and benefits associated with the rule.

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87 Id.

88 44 U.S.C. 3501 et seq.

A. Benefits

Rule 10b-21 is intended to address abusive "naked" short selling and fails to deliver. The rule is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive broker-dealers, participants of a registered clearing agency, or purchasers about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. Among other things, Rule 10b-21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[89] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold.[90]

A seller misrepresenting its short sale locate source or ownership of shares may intend to fail to deliver securities in time for settlement and, therefore, engage in abusive "naked" short selling. As noted above, although abusive "naked" short selling is not defined in the federal securities laws, it refers generally to selling short without having stock available for delivery and intentionally failing to deliver stock within the standard three-day settlement cycle.[91] Such short selling may or may not be part of a scheme to manipulate the price of a security. Although "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b-5 under the Exchange Act,[92] Rule 10b-21 will further evidence the specific liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that

89 See 17 CFR 242.203(b)(1).

90 See Rule 10b-21.

91 See supra note 2.

92 17 CFR 240.10b-5.

fail to deliver securities by settlement date. We believe that a rule specifying the illegality of these activities will focus the attention of market participants on such activities. The rule will also further evidence that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. Thus, the rule takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. As noted above, issuers and investors have expressed concerns about fails to deliver in connection with "naked" short selling. For example, in response to the 2006 Regulation SHO Proposed Amendments, we received a number of comments that expressed concerns about "naked" short selling and extended delivery failures.[93] Commenters continued to express these concerns in response to the 2007 Regulation SHO Proposed Amendments,[94] and in response to the Proposing Release.[95]

To the extent that fails to deliver might be indicative of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price,[96] such fails to deliver may undermine the confidence of investors.[97] These investors, in turn, may be reluctant

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[93] See supra note 36.

[94] See supra note 37.

[95] See supra note 38.

[96] See supra note 39.

[97] See supra note 40.

to commit capital to an issuer they believe to be subject to such manipulative conduct.[98] In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding fails to deliver in the issuer's security.[99] Any unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security's price.[100]

Thus, to the extent that fails to deliver might create a misleading impression of the market for an issuer's securities, the rule will benefit investors and issuers by taking direct aim at an activity that may create fails to deliver. In addition, to the extent that "naked" short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the rule will improve investor confidence about the security. In addition, the rule will lead to greater certainty in the settlement of securities which should strengthen investor confidence in that process.

We believe the rule will result in broker-dealers having greater confidence that their customers have obtained a valid locate source and, therefore, that shares are available for delivery on settlement date. Thus, the rule will aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, to the extent that the rule results in fewer sales of threshold securities resulting in fails to deliver, the rule will reduce costs to broker-dealers because such broker-dealers will have to close-out a

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98 See supra note 41.

99 See supra note 42 (discussing the fact that due to such concerns some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the DTC or broker-dealers).

100 See supra note 43.

lesser amount of fails to deliver under Regulation SHO's close-out requirement.[101] The rule should also help reduce manipulative schemes involving "naked" short selling.

In the Proposing Release, we solicited comment on any additional benefits that could be realized with the proposed rule, including both short-term and long-term benefits. We also solicited comment regarding benefits to market efficiency, pricing efficiency, market stability, market integrity and investor protection. In response, one commenter stated that the "rule will have a positive impact on liquidity and market quality in securities traded."[102] Another commenter stated that "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, . . . in this regard, the strict application of the rule . . . should enhance liquidity and the market quality of securities traded."[103] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and thereby reduce the likelihood of short squeezes."[104]

B. Costs

Rule 10b-21 is intended to address abusive "naked" short selling by further evidencing the liability of persons that deceive specified persons about their intention or ability to deliver

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[101] Rule 203(b)(3)(iii) of Regulation SHO contains a close-out requirement that applies only to broker-dealers for securities in which a substantial amount of fails to deliver have occurred, also known as "threshold securities." Specifically, Rule 203(b)(3)'s close-out requirement requires a participant of a clearing agency registered with the Commission to take immediate action to close out a fail to deliver position in a threshold security in the CNS system that has persisted for 13 consecutive settlement days by purchasing securities of like kind and quantity; see also 2008 Interim Rule, supra note 29 (temporarily enhancing Regulation SHO's delivery requirements for sales of all equity securities).

[102] See letter from Susanne Trimbath, Ph.D., CEO and Chief Economist, STP Advisory Services, LLC, dated May 30, 2008 ("Trimbath") (noting also a tax benefit to investors from enforcing delivery on settlement date).

[103] See letter from Shapiro.

[104] See id.

securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. In the Proposing Release, we sought data supporting any potential costs associated with the rule, and specific comment on any systems changes to computer hardware and software, or surveillance costs that might be necessary to implement the rule. One commenter stated that "the rule will have a positive impact on liquidity and market quality in securities traded . . . [w]ithout strict rules against settlement failures, a systemic crisis could occur where investors are reluctant to engage in trades in US markets because settlement finality is in question. The markets and investors need the assurance of Rule 10b-21 that securities transactions will be settled."[105] Another commenter stated that "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, . . . in this regard, the strict application of the rule . . . should enhance liquidity and the market quality of securities traded."[106] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and thereby reduce the likelihood of short squeezes. The prospect of short squeezes is increased by the moral hazard that occurs when short sellers believe there is little or no cost to carrying out abusive naked short sales, and therefore rules that impose such costs reduce this prospect."[107] The commenter also noted that any costs associated with purchasing or borrowing securities to deliver on a sale instead of allowing the fail to deliver position to remain open "would not

105 See letter from Trimbath.

106 See letter from Shapiro.

107 See id.

represent an additional cost, since a legitimate short sale involves borrowing the security for delivery at the cost of such borrowing. Therefore, it would reflect only the cost of complying with the rules and laws that apply to all investors."[108] This commenter also noted that "[s]trict liability for failing to deliver securities in short sales is needed to offset the implicit savings of violating the law and rules, and getting away with it."[109]

We recognize, however, that Rule 10b-21 may result in increased costs to broker-dealers to the extent that the rule encourages or results in broker-dealers limiting the extent to which they rely on customer assurances in complying with the locate requirement of Regulation SHO. In addition, the rule may result in increased costs to sellers who inadvertently fail to deliver securities because such sellers, in an attempt to avoid liability under the rule, might purchase or borrow securities to deliver on a sale at a time when, but for the rule, the seller would have allowed the fail to deliver position to remain open.

One commenter stated that, "unless Proposed Rule l0b-21 were modified to eliminate aiding and abetting liability and allow reliance upon customer assurances, the price discovery and liquidity provided through short sales may be constrained."[110] Although broker-dealer concerns regarding aiding and abetting liability under Rule 10b-21 may potentially impact liquidity and efficiency in the markets, we believe that such an impact, if any, will be minimal. Rule 10b-21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. Aiding and abetting liability is a question of fact, determined on a case-by-case basis. In addition, as we stated in the

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108 See id.

109 See id.

110 See letter from Bingham.

Proposing Release, broker-dealers would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws.[111]

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and whenever it is required to consider or determine if an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.[112] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition.[113] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Rule 10b-21 is intended to address abusive "naked" short selling and fails to deliver. The rule is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker-dealer, about their intention or ability to deliver securities in time for settlement and fail to deliver securities by settlement date. Among other things, Rule 10b-21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with Regulation SHO's "locate" requirement.[114] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold.[115]

[111] See Proposing Release, 72 FR at 15377.

[112] 15 U.S.C. 78c(f).

[113] 15 U.S.C. 78w(a)(2).

[114] See 17 CFR 242.203(b)(1).

[115] See Rule 10b-21.

Although "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, including Rule 10b-5 under the Exchange Act,[116] Rule 10b-21 will further evidence the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. We believe that a rule further evidencing the illegality of these activities will focus the attention of market participants on such activities. The rule will also provide a measure of predictability for market participants. We believe Rule 10b-21 will have minimal impact on the promotion of price efficiency.

In the Proposing Release, we sought comment regarding whether Rule 10b-21 will adversely impact liquidity, disrupt markets, or unnecessarily increase risks or costs to customers. In response, one commenter noted that, "the liquidity of the market and the market quality of securities traded can be threatened or damaged if investors perceive that naked short sales may artificially distort the price of securities, in ways and instances unknown to honest investors, . . . in this regard, the strict application of the rule . . . should enhance liquidity and the market quality of securities traded."[117] This commenter also noted that, "[b]y increasing the liability of naked short sellers, the proposed rule should reduce the incidence of naked short sales and thereby reduce the likelihood of short squeezes. . . ."[118]

Another commenter stated that, "unless Proposed Rule 10b-21 were modified to eliminate aiding and abetting liability and allow reliance upon customer assurances, the price discovery

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[116] 17 CFR 240.10b-5.

[117] See letter from Shapiro.

[118] See id.

and liquidity provided through short sales may be constrained."[119] Although broker-dealer concerns regarding aiding and abetting liability under Rule 10b-21 may potentially impact liquidity and efficiency in the markets, we believe that such an impact, if any, will be minimal. Rule 10b-21 as adopted does not impose any additional liability or requirements on any person, including broker-dealers, beyond those of any existing Exchange Act rule. Aiding and abetting liability is a question of fact, determined on a case-by-case basis. In addition, as we stated in the Proposing Release, broker-dealer's would remain subject to liability under Regulation SHO and the general antifraud provisions of the federal securities laws.[120]

In addition, we believe that the rule will have minimal impact on the promotion of capital formation. The perception that abusive "naked" short selling is occurring in certain securities can undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct. For example, in response to the Proposing Release, one commenter noted that, "[c]onfidence in the securities markets is diminished when investors and others cannot rely on the receipt of securities in trades."[121] Thus, we believe that strengthening our rules against "naked" short selling by targeting sellers who deceive their broker-dealers about their source of borrowable shares and their share ownership will provide increased confidence in the markets.

In addition, we note that we have previously sought comment regarding the impact on capital formation of other proposed amendments aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling, including whether the proposed increased

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119 See letter from Bingham.

120 See Proposing Release, 72 FR at 15377.

121 See letter from Trimbath.

short sale restrictions would affect investors' decisions to invest in certain equity securities.[122] In response, commenters expressed concern about the potential impact of "naked" short selling on capital formation claiming that "naked" short selling causes a drop in an issuer's stock price that may limit the issuer's ability to access the capital markets.[123] Thus, to the extent that "naked" short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the rule is expected to improve investor confidence about the security. We note, however, that persistent fails to deliver exist in only a small number of securities and may be a signal of overvaluation rather than undervaluation of a security's price.[124] In addition, we believe that the rule will lead to greater certainty in the settlement of securities, which is expected to strengthen investor confidence in the settlement process.

We also believe that Rule 10b-21 will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. By specifying that abusive "naked" short selling is a fraud, the Commission believes the rule will promote competition by providing the industry with guidance regarding the liability of sellers that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate sources or share ownership and that fail to deliver securities by settlement date.

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[122] See 2006 Regulation SHO Proposed Amendments, 71 FR 41710; 2007 Regulation SHO Proposed Amendments, 72 FR 45558.

[123] See, e.g., supra note 41 (citing to comment letters expressing concern regarding the impact of potential "naked" short selling on capital formation).

[124] Persistent fails to deliver may be symptomatic of an inadequate supply of shares in the equity lending market. If short sellers are unable to short sell due to their inability to borrow shares, their opinions about the fundamental value of the security may not be fully reflected in a security's price, which may lead to overvaluation.

VII. Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),[125] regarding Rule 10b-21 under the Exchange Act. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release. We solicited comments on the IRFA.

A. Reasons for the Rule

Rule 10b-21 is intended to address fails to deliver associated with abusive "naked" short selling. While "naked" short selling as part of a manipulative scheme is already illegal under the general antifraud provisions of the federal securities laws, Rule 10b-21 specifies that it is unlawful for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its intention or ability to deliver securities on the date delivery is due, and such person fails to deliver the security on or before the date delivery is due. Thus, Rule 10b-21 will further evidence the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares.

B. Objectives

Rule 10b-21 is aimed at short sellers, including broker-dealers acting for their own accounts, that deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. We believe that a rule further evidencing the illegality of these activities will focus the

[125] 5 U.S.C. 603.

attention of market participants on such activities. The rule will also underscore that the Commission believes such deceptive activities are detrimental to the markets and will provide a measure of predictability for market participants.

All sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. Thus, Rule 10b-21 takes direct aim at an activity that may create fails to deliver. Those fails can have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending. They also may create a misleading impression of the market for an issuer's securities. Rule 10b-21 will also aid broker-dealers in complying with the locate requirement of Regulation SHO and, thereby, potentially reduce fails to deliver. In addition, the rule is expected to help reduce manipulative schemes involving "naked" short selling.

C. Significant Issues Raised By Public Comment

The IRFA appeared in the Proposing Release. We requested comment on any aspect of the IRFA. In particular, we requested comment on: (i) the number of small entities that would be affected by the rule; and (ii) the existence or nature of the potential impact of the rule on small entities. We requested that the comments specify costs of compliance with the rule, and suggest alternatives that would accomplish the objectives of the rule. We did not receive any comments that responded specifically to this request.

D. Small Entities Subject to the Rule

The entities covered by Rule 10b-21 will include small broker-dealers, small businesses, and any investor who effects a short sale that qualifies as a small entity. Although it is impossible to quantify every type of small entity that may be able to effect a short sale in a security, paragraph (c)(1) of Rule 0-10 under the Exchange Act[126] 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 2007, the Commission estimates that there were approximately 896 broker-dealers that qualified as small entities as defined above.[127]

Any business, however, regardless of industry, could be subject to the rule if it effects a short or long sale. The Commission believes that, except for the broker-dealers discussed above, an estimate of the number of small entities that fall under the rule is not feasible.

E. Reporting, Recordkeeping, and other Compliance Requirements

Rule 10b-21 is intended to address abusive "naked" short selling by further evidencing the liability of persons that deceive specified persons about their intention or ability to deliver securities in time for settlement, including persons that deceive their broker-dealer about their locate source or ownership of shares and that fail to deliver securities by settlement date. The Commission believes that the rule may impose new or additional compliance costs on any affected party, including broker-dealers, that are small entities. To comply with Regulation SHO, small broker-dealers needed to modify their systems and surveillance mechanisms to comply with Regulation SHO's locate, marking and delivery requirements. Thus, any systems and surveillance mechanisms necessary for broker-dealers to comply with the rule should already be in place. We believe that any necessary additional systems and surveillance changes, in

[126] 17 CFR 240.0-10(c)(1).

[127] These numbers are based on OEA's review of 2007 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

particular changes by sellers who are not broker-dealers, will be similar to the changes incurred by broker-dealers when Regulation SHO was implemented.

F. Agency Action to Minimize Effect on Small Entities

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. Pursuant to Section 3(a) of the RFA,[128] the Commission must consider the following types of alternatives: (a) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the rule, or any part thereof, for small entities.

A primary goal of Rule 10b-21 is to address abusive "naked" short selling. While "naked" short selling as part of a manipulative scheme is always illegal under the general antifraud provisions of the federal securities laws, Rule 10b-21 specifies that it is a fraud for any person to submit an order to sell an equity security if such person deceives a broker-dealer, participant of a registered clearing agency, or purchaser about its intention or ability to deliver the security on the date delivery is due and such person fails to deliver the security on or before the date delivery is due. Rule 10b-21 is aimed at short sellers, including broker-dealers acting for their own accounts, who deceive specified persons, such as a broker or dealer, about their intention or ability to deliver securities in time for settlement and who do not deliver securities by settlement date. Among other things, Rule 10b-21 targets short sellers who deceive their broker-dealers about their source of borrowable shares for purposes of complying with

[128] 5 U.S.C. 603(c).

Regulation SHO's "locate" requirement.[129] The rule also applies to sellers who misrepresent to their broker-dealers that they own the shares being sold.

We believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the Commission's goal of addressing abusive "naked" short selling and fails to deliver. In addition, we have concluded similarly that it is not consistent with the primary goal of the rule to further clarify, consolidate, or simplify the rule for small entities. Finally, the rule imposes performance standards rather than design standards.

VIII. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 17A, 19 and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78f, 78i(h), 78j, 78k-1, 78o, 78o-3, 78q, 78q-1, 78s and 78w(a), the Commission is adopting a new antifraud rule, Rule 10b-21, to address abusive "naked" short selling.

List of Subjects in 17 CFR Part 240

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows.

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

1. The authority citation for part 240 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-

[129] See 17 CFR 242.203(b)(1).

5, 78w, 78x, 78<u>ll</u>, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 <u>et</u>. <u>seq</u>.; and 18 U.S.C. 1350, unless otherwise noted.

2. Add § 240.10b-21 to read as follows:

§ 240.10b-21 Deception in connection with a seller's ability or intent to deliver securities on the date delivery is due.

<u>PRELIMINARY NOTE to § 240.10b-21: This rule is not intended to limit, or restrict, the applicability of the general antifraud provisions of the federal securities laws, such as section 10(b) of the Act and rule 10b-5 thereunder.</u>

(a) It shall also constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of this Act for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before the settlement date.

(b) For purposes of this rule, the term <u>settlement date</u> shall mean the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 14, 2008

Commissioners Walter and Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2800A / October 15, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13274

In the Matter of BATTERY WEALTH MANAGEMENT, INC. AND WAYNE CASSADAY, Respondents.	**CORRECTED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AS TO BATTERY WEALTH MANAGEMENT, INC. AND PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AS TO WAYNE CASSADAY**

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(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Battery Wealth Management, Inc. ("Battery") and instituted pursuant to Sections 203(f) and 203(k) of the Advisers Act against Wayne Cassaday ("Cassaday") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 as to Battery Wealth Management, Inc. and Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 as to Wayne Cassaday, ("Order"), as set forth below.

III.

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

RESPONDENTS

1. Battery Wealth Management, Inc., a South Carolina corporation, registered with the Commission as an investment adviser on April 21, 2006. Battery ceased doing business in August 2007. Battery's registration with the Commission terminated on December 31, 2007.

2. Wayne Cassaday, 48, is president and chief compliance officer of Battery. Cassaday resides in Mt. Pleasant, South Carolina.

OTHER RELEVANT PARTIES

3. Albert E. Parish, Jr. ("Parish") was a vice-president, co-founder and co-owner of Battery. Parish controlled a South Carolina LLC ("the LLC"), formed in 1996, which purported to be "an investment pool, business forecast and economic litigation firm." The LLC was located in Summerville, South Carolina, a suburb of Charleston and was not registered with the Commission as an investment adviser.

BACKGROUND

4. The predecessor to Battery was formed in 1999 by Cassaday, Parish and three accountants. In 2003, the three accountants resigned from the company and the company, owned two-thirds by Cassaday and one-third by Parish, was renamed Battery.

5. During 2003, 2004 and 2005, Battery's business grew rapidly and by 2005 Battery's assets under management exceeded $30 million.

THE FRAUDULENT SCHEME

6. Beginning in 1986, long before his association with Battery, Parish offered investments in what he called his Futures Pool, which purportedly invested in futures contracts. Later, around 1996, Parish began four other pools which he described to investors as "informal pools of money" that were invested in bonds (the Hedged Income Pool), stocks (the Stock Pool), hard assets such as jewelry and fine art (the Hard Asset Pool) and a Loan Pool which consisted of his personal promissory notes which he sold to investors. Investors purchased an undivided interest in the assets of a given pool. The investment pools purportedly held and traded the assets under Parish's name. The LLC maintained a public website that in 2007 falsely described the investment pools as holding over $134 million in assets and provided unrestricted access to the funds' subscription agreements. The LLC acted as an investment adviser to the investment pools.

7. Beginning in 2002, Battery recommended to its clients that they participate in Parish's investment pools. Battery, through Cassaday and Parish, ultimately sold $6.5 million of these investments to 25 of Battery's clients.

8. The LLC provided quarterly statements to investors that showed positive performance and ever increasing asset values. Before recommending that Battery's clients invest in the pools, Cassaday reviewed the quarterly account statements provided by Parish's LLC and discussed the investment pools with Parish. Cassaday also viewed Parish's website, which was provided as a direct link from Battery's website.

9. Cassaday ignored certain facts that strongly suggested that Parish was likely deceiving advisory clients. Cassaday had reviewed Parish's personal financial statements, which showed that Parish's sources of reported income were disproportionately low in comparison to the high level of personal expenses reflected by his lavish and flamboyant lifestyle. Cassaday knew that Parish's Loan Pool consisted of Parish's personal notes, and that Parish had issued his notes to (and was thus borrowing money from) the IRA accounts of many of Battery's clients. In the fall of 2006, Cassaday was told that Parish was experiencing personal cash flow problems. Cassaday subsequently learned that a property Parish owned might face foreclosure. Cassaday also discovered that one of Parish's investment pools had been unable to comply with a redemption request from a Battery client within the requisite 5-day period and instead required six weeks to return the investor's money. Parish admitted to Cassaday that he had deliberately delayed the investor's redemption in hopes of finding a replacement investor funds to avoid the liquidation of specific bonds. Nevertheless, Cassaday never took any steps to follow up on these red flags or to inquire whether the pooled funds in which Battery advised its clients to invest were, in fact, investing consistent with the representations made to investors.

10. In February 2007, staff of the Commission's Office of Compliance Inspections and Examinations began an examination of Battery. As a part of that examination, the staff requested that Battery produce brokerage statements supporting the claimed account valuations in the various the pools.

11. In March 2007, in response to the staff's request, Parish produced brokerage account statements reflecting account valuations of $11 million in the Stock Pool and $18 million in the Hedged Income Pool as of December 31, 2006. The Commission's staff contacted the broker-dealers that purportedly issued the account statements and determined that the statements were forged. The accounts actually held securities and cash with a value of less than $100,000. Parish also provided the Commission's staff with a commodities account statement purporting to hold approximately $50 million in the Futures Pool. That statement was also fictitious. The account held only $130,000. Contrary to representations to investors, Parish had misappropriated or lost assets invested in the pools. Approximately $90 million of investor funds were unaccounted for or lost.

12. Subsequently, in April 2007, the scheme ended when the Commission filed an emergency civil injunctive action against Parish, the LLC and a related entity. On May 4, 2007, a federal district court enjoined Parish, the LLC and a related entity from violating 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 from violating or aiding and abetting violations of Sections 206(1) and (2) of the Advisers Act. SEC v. Albert E. Parish, Jr., Parish Economics LLC and Summerville Hard Assets LLC, Lit. Rel. No. 10107 (May 9, 2007). The Commission subsequently barred Parish from association with any investment adviser. In re Albert E. Parish Jr., IA Rel No. 2607 (May 25, 2007).

13. Between 2002, when Cassaday first recommended that clients invest with Parish, and 2007, when the scheme was discovered, Battery received approximately $97,363 in fees based upon the client assets invested in the pools. Cassaday received approximately $5,864 of that amount.

14. Sections 206(1) and 206(2) of the Advisers Act prohibit an investment adviser from employing any device, scheme, or artifice to defraud clients or engage in any transaction, practice, or course of business that defrauds clients. Section 206 establishes federal fiduciary standards to govern the conduct of investment advisers. Transamerica Mortgage Advisers, Inc. v. Lewis, 444 U.S. 11, 17 (1979). The fiduciary duties of investment advisers to their clients include the duty to act for the benefit of their clients, the duty to exercise the utmost good faith in dealing with clients, the duty to disclose all material facts, and the duty to employ reasonable care to avoid misleading clients. SEC v. Capital Gains Research Bureau, Inc. et al., 375 U.S. 180, 194, (1983). Scienter is required to establish a violation of Section 206(1) but is not a required element of Section 206(2). SEC v. Steadman, 967 F.2d 636, 643 fn.5 (D.C. Cir. 1992) (Section 206(2) violation only requires proof of negligence, not scienter).

15. Battery willfully violated Sections 206(1) and 206(2) by advising its clients, through Parish and Cassaday, to invest in the investment pools although Parish knew the pools did not have the claimed assets and that the purported returns were fictitious and Cassaday took no steps to verify the pools' assets or returns. By directing its clients to invest in funds that were being looted by Parish, an officer and part-owner of Battery, Battery defrauded its clients.

16. To establish aiding and abetting liability, the Commission must show that: (1) a primary violation occurred; (2) the aider and abettor provided substantial assistance; and (3) the aider and abettor rendered such assistance knowingly or with extreme recklessness. See Howard v. SEC, 376 F.3d 1136, 1143 (D.C. Cir. 2004). The knowledge and awareness requirement may be established by recklessness when the aider and abettor is a fiduciary. Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990).

17. Cassaday provided substantial assistance to the fraudulent scheme by recommending that Battery's clients invest in the pools despite knowing certain facts that strongly suggested that Parish was likely deceiving advisory clients. Cassaday thus willfully aided and abetted and caused Battery's violations of Sections 206(1) and 206(2).

BATTERY'S COMPLIANCE POLICIES

18. Section 206(4) of the Advisers Act and Rule 206(4)-7, promulgated thereunder, require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules promulgated thereunder and to evaluate annually the effectiveness of those policies and their implementation.

19. Battery's Compliance Manual, which was a generic compliance manual purchased for $179, did not address the particular risks of Battery's business, particularly the conflicts of interest resulting from Parish's operation of a side business that offered and managed pooled funds that Parish and Cassaday recommended to Battery's advisory clients. In addition, the manual did not address conflicts of interest arising from borrowing by insiders from advisory clients. Cassaday, as Battery's president and chief compliance officer, was responsible for the manual and its deficiencies.

20. As a result of the conduct described above, Battery willfully violated and Cassaday willfully aided and abetted and caused violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

DISGORGEMENT AND CIVIL PENALTIES

24. Respondent Battery has submitted a sworn Statement of Financial Condition dated October 16, 2007, as amended by letter dated August 8, 2008, and other evidence and has asserted its inability to pay disgorgement plus prejudgment interest or to pay a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondents Battery's and Cassaday's Offers.

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

A. Respondent Battery cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder

B. Respondent Cassaday cease and desist from committing or causing any violations or future violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

C. Respondent Battery is hereby censured.

D. Respondent Cassaday be, and hereby is barred from association with any investment adviser, with the right to reapply for association after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission;

E. Any reapplication for association by the Respondent Cassaday 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.

F. Respondent Battery shall pay disgorgement of $97,363 plus prejudgment interest in the amount of $12,744 but payment of such amount is waived and no civil penalty imposed based upon Respondent's sworn representations in its Statement of Financial Condition dated October 16, 2007, as amended by letter dated August 8, 2008, and other documents submitted to the Commission.

G. Respondent Cassaday shall, pay disgorgement of $5,864 and prejudgment interest of $867 for a total of $6,731, and shall pay a civil penalty of $40,000. Cassaday shall pay this $6,731 as follows: (1) $6,731 within 20 days of entry of this Order. Thereafter, Cassaday shall pay the balance owed plus post-judgment interest thereon within 365 days of entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Each 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; and to be sent to the SEC Operations Center, 6432 General Green Way, Alexandria, VA 22312 Stop 0-3; and (D) submitted under cover letter that identifies Cassaday 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 William P. Hicks, Regional Trial Counsel, Securities and Exchange Commission, 3475 Lenox Rd., N.E., Suite 500, Atlanta GA 30326-1232.

H. Respondent Cassaday agrees that if the full amount of any payment described above is not made by the date the payment is required by this Order, the entire amount of disgorgement, prejudgment interest, and civil penalties plus any interest accrued pursuant to SEC Rule of Practice 600 as to disgorgement and any interest accrued pursuant to 31 U.S.C. § 3717 for civil penalties minus payments made, if any, is due and payable immediately without further application;

I. 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 Battery provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest. 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 disgorgement and interest should not be ordered; (3) contest the amount of disgorgement and interest to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Commissioner Walter and
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 58790 / October 15, 2008

Administrative Proceeding
File Number 3-11893

In the Matter of David A. Finnerty, Donald R. Foley II, Scott G. Hunt, Thomas J. Murphy, Jr., Kevin M. Fee, Frank A. Delaney IV, Freddy DeBoer, Todd J. Christie, James V. Parolisi, Robert W. Luckow, Patrick E. Murphy, Robert A. Johnson, Jr., Patrick J. McGagh, Jr., Joseph Bongiorno, Michael J. Hayward, Richard P. Volpe, Michael F. Stern, Warren E. Turk, Gerard T. Hayes, and Robert A. Scavone, Jr. Respondents.	ORDER MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO THOMAS J. MURPHY, JR.

I.

On April 12, 2005, the Securities and Exchange Commission ("Commission") entered an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 11b-1 Thereunder ("OIP") against respondent Thomas J. Murphy, Jr ("Murphy").

II.

Murphy has submitted an Offer of Settlement ("Offer") in these administrative proceedings, 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, Murphy consents to the entry of this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C Securities Exchange Act of 1934 as to Thomas J. Murphy, Jr., as set forth below.

III.

On the basis of this Order and Murphy's Offer, the Commission finds[1] that:

FACTS

1. Murphy is one of several respondents in pending administrative and cease-and-desist proceedings, file number 3-11893, who have been charged with improper trading during the period from at least 1999 through June 30, 2003 (the "Relevant Period"), while they were acting as specialists on the New York Stock Exchange ("NYSE").

2. Murphy, age 44, of Rockville Centre, New York, acted as a specialist on the NYSE at Fleet Specialist, Inc. (now known as Banc of America Specialist, Inc.) ("Fleet") and a Fleet predecessor firm from at least March 2000 to approximately March 2004.

3. During the Relevant Period charged in the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 Thereunder, Murphy acted as a specialist in Electronic Data Systems ("EDS") (from approximately October 2000 to approximately January

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

2001) and Johnson & Johnson ("JNJ") (from approximately February 2001 through June 2003).

4. As a specialist, Murphy had an obligation to serve public customer orders over the proprietary interests of the firm with whom he was formerly employed, Fleet. In his role as a specialist, Murphy had a general duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from Fleet's own account when those customer orders could be matched with other customer orders.

5. Interpositioning involves a two-step process that allows the specialist to generate a profit for the specialist firm from the spread between two opposite trades. Interpositioning can take various forms. In one form, the specialist purchases stock for the specialist firm's proprietary account from the customer sell order, and then fills the customer buy order by selling from the specialist firm's proprietary account at a higher price. A second form of interpositioning involves the specialist selling stock into the customer buy order, and then filling the customer sell order by buying for the specialist firm's proprietary account at a lower price. In both forms of interpositioning, the specialist participates on both sides of the trade, thereby capturing the spread between the purchase and sale prices, disadvantaging at least one of the parties to the transaction.

6. Trading ahead involves a practice whereby the specialist fills an agency order through a proprietary trade for the specialist firm's proprietary account – by improperly 'stepping in front' of, or 'trading ahead' of, another agency order. Unlike interpositioning, the practice of "trading ahead" does not necessarily involve a second specialist trade for the specialist firm's proprietary account into the opposite, disadvantaged agency order. For example, in a declining market, a specialist may "trade ahead" by filling a market buy order by selling stock from the specialist firm's proprietary account in front of an agency market sell order. In so doing, the specialist would execute a trade for the proprietary account at a higher price, then fill the agency sell order *after* the proprietary trade, thereby resulting in the agency market sell order receiving a lower price as the price of the stock fell.

7. During the Relevant Period, in EDS and JNJ, Murphy executed hundreds of trades that constituted interpositioning, which generated thousands of dollars in profit for his firm's proprietary account at the expense of customer orders, and hundreds of trades that constituted trading ahead, which generated thousands of dollars in customer harm.

APPLICABLE LAW

Section 11(b) of the Exchange Act and Rule 11b-1 Thereunder

8. Section 11(b) of the Exchange Act and Rule 11b-1 thereunder require various limitations on the operations of specialists, including limiting a specialist's dealer transactions to those "reasonably necessary to permit him to maintain a fair and orderly market." Section 11(b) and Rule 11b-1 permit a national securities exchange to promulgate rules that allow a member to register as a specialist and to act as a dealer. Under Rule 11b-1 if the Commission finds, after appropriate notice and opportunity for hearing, that a specialist has for any account in which he has an interest "effected transactions ... which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market," and were "not effected in a manner consistent with the rules adopted by such exchange," the Commission may order the exchange to suspend or cancel the specialist's registration. If, however, the exchange itself has suspended or canceled the specialist's registration, no further sanction shall be imposed unless the Commission finds "substantial or continued misconduct."

9. Where specialists make trades for their firm's proprietary accounts that are not "reasonably necessary to permit [such specialists] to maintain a fair and orderly market," they have violated Section 11(b) and Rule 11b-1 of the Exchange Act. The Commission has brought settled actions for sanctions under Exchange Act Section 15(b) against specialists under Section 11(b) and Rule 11b-1. See In the Matter of Albert Fried & Co. and Albert Fried, Jr., 1978 WL 196046, S.E.C. Release No. 34-15293 (Nov. 3, 1978).

10. Several NYSE rules prohibit a specialist from trading ahead of a customer order, as well as from engaging in interpositioning, and require agency orders to be matched whenever possible, consistent with a specialist's duty to maintain a fair and orderly market.

11. NYSE Rule 104 (Dealings by Specialists), which sets forth specialists' obligations, prohibits specialists from trading for their own accounts unless it is reasonably necessary to maintain a fair and orderly market. This is known as the negative obligation. Rule 104 states in relevant part: "No specialist shall effect . . . purchases or sales of any security in which such specialist is registered . . ., unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."[2]

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[2] Rule 104.10(3), which describes specialists' affirmative obligations, also expands on the negative obligation:

> Transactions on the Exchange for his own account effected by a member acting as a specialist must constitute a course of dealings

12. NYSE Rule 92 (Limitations on Members' Trading Because of Customers Orders) generally prohibits a member from entering a proprietary order to buy (or sell) a security while in possession of an executable buy (or sell) agency order that could be executed at the same price. During the Relevant Period, Rule 92 stated in relevant part:

> No member shall personally buy . . . any security . . . for his own account or for any account in which he is . . . interested . . . while such member personally holds or has knowledge that his member organization holds an unexecuted market order to buy such security . . . for a customer.[3]

13. Similarly, NYSE Rule 92 also applies to the specialist buying or selling a security while holding an unexecuted market buy or sell order, as well as to circumstances where the specialist holds unexecuted customer limit orders at a price that could be satisfied by the proprietary transaction effected by the specialist.

14. NYSE Rule 123B (Exchange Automated Order Routing Systems) requires specialists to cross orders received over the DOT system. Rule 123B(d) states in relevant part: "a specialist shall execute System orders in accordance with Exchange auction market rules and procedures, including requirements to expose orders to buying and selling interest in the trading crowd and *to cross orders before buying or selling from his own account.*" (Emphasis added).

15. NYSE Rule 401 requires NYSE members to "adhere to the principles of good business practice in the conduct of his or its business affairs." Similarly, NYSE

> reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. Transactions not part of such a course of dealings ... are not to be effected.

[3] Rule 92 was amended on January 7, 2002 to read in relevant part:

> [n]o member or member organization shall cause the entry of an order to buy (sell) any Exchange-listed security for any account in which such member or member organization or any approved person thereof is directly or indirectly interested (a "proprietary order"), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price.

Rule 476(a)(6) provides sanctions if NYSE members are adjudged guilty of "conduct or proceeding inconsistent with just and equitable principles of trade."

16. As a result of the conduct described above, Murphy violated the aforementioned NYSE rules and violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the cease-and-desist order agreed to in Murphy's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, Murphy shall cease and desist from committing or causing any violations and any future violations of Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Walter and
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 8979 / October 15, 2008

Securities Exchange Act of 1934
Release No. 58791 / October 15, 2008

Administrative Proceeding
File Number 3-11893

In the Matter of David A. Finnerty, Donald R. Foley II, Scott G. Hunt, Thomas J. Murphy, Jr., Kevin M. Fee, Frank A. Delaney IV, Freddy DeBoer, Todd J. Christie, James V. Parolisi, Robert W. Luckow, Patrick E. Murphy, Robert A. Johnson, Jr., Patrick J. McGagh, Jr., Joseph Bongiorno, Michael J. Hayward, Richard P. Volpe, Michael F. Stern, Warren E. Turk, Gerard T. Hayes, and Robert A. Scavone, Jr. Respondents.	ORDER DISMISSING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS INSTITUTED PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b), 21C AND 11(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 11b-1 THEREUNDER AS TO PATRICK E. MURPHY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest 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), 21C and 11(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 11b-1 thereunder against Respondent Patrick E. Murphy ("Murphy").

II.

Murphy 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 him and the subject matter of these proceedings, which are admitted, Murphy consents to the entry of this Order Dismissing Administrative and Cease-and-Desist Proceedings Instituted Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 21C and 11(b) of the Securities Exchange Act of 1934 And Rule 11b-1 Thereunder as to Patrick E. Murphy, as set forth below.

III.

On the basis of this Order and Murphy's Offer, the Commission finds[1] that:

Respondent

1. Murphy is a resident of Monmouth Beach, New Jersey. Murphy acted as a specialist at Spear Leeds & Kellogg L.P. from at least January 2000 to approximately March 2003.

Background

2. On April 12, 2005, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 thereunder ("OIP") against Murphy and other Respondents. Since the institution of the OIP, the administrative record developed during these proceedings makes it appropriate for the OIP to be dismissed as to Murphy.

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

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to dismiss the OIP as to Murphy.

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), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 Thereunder issued against Murphy on April 12, 2005 is hereby DISMISSED.

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Walter and
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 58792 / October 15, 2008

Administrative Proceeding
File Number 3-11893

In the Matter of David A. Finnerty, Donald R. Foley II, Scott G. Hunt, Thomas J. Murphy, Jr., Kevin M. Fee, Frank A. Delaney IV, Freddy DeBoer, Todd J. Christie, James V. Parolisi, Robert W. Luckow, Patrick E. Murphy, Robert A. Johnson, Jr., Patrick J. McGagh, Jr., Joseph Bongiorno, Michael J. Hayward, Richard P. Volpe, Michael F. Stern, Warren E. Turk, Gerard T. Hayes, and Robert A. Scavone, Jr. Respondents.	ORDER MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO KEVIN M. FEE

I.

On April 12, 2005, the Securities and Exchange Commission ("Commission") entered an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 11b-1 Thereunder ("OIP") against respondent Kevin M. Fee ("Fee").

II.

Fee has submitted an Offer of Settlement ("Offer") in these administrative proceedings, 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, Fee consents to the entry of this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C Securities Exchange Act of 1934 as to Kevin M. Fee, as set forth below.

III.

On the basis of this Order and Fee's Offer, the Commission finds[1] that:

FACTS

1. Fee is one of several respondents in pending administrative and cease-and-desist proceedings, file number 3-11893, who have been charged with improper trading during the period from at least 1999 through June 30, 2003 (the "Relevant Period"), while they were acting as specialists on the New York Stock Exchange ("NYSE").

2. Fee, age 40, of Ridgewood, New Jersey, acted as a specialist on the NYSE at Bear Wagner Specialists LLC ("Bear Wagner") from at least March 2000 to approximately November 2004.

3. During the Relevant Period charged in the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 Thereunder, Fee acted as a specialist in Texas Instruments, Inc. ("TXN") (from approximately March 2000 through June 2003).

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

4. As a specialist, Fee had an obligation to serve public customer orders over the proprietary interests of the firm with whom he was formerly employed, Bear Wagner. In his role as a specialist, Fee had a general duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from Bear Wagner's own account when those customer orders could be matched with other customer orders.

5. Interpositioning involves a two-step process that allows the specialist to generate a profit for the specialist firm from the spread between two opposite trades. Interpositioning can take various forms. In one form, the specialist purchases stock for the specialist firm's proprietary account from the customer sell order, and then fills the customer buy order by selling from the specialist firm's proprietary account at a higher price. A second form of interpositioning involves the specialist selling stock into the customer buy order, and then filling the customer sell order by buying for the specialist firm's proprietary account at a lower price. In both forms of interpositioning, the specialist participates on both sides of the trade, thereby capturing the spread between the purchase and sale prices, disadvantaging at least one of the parties to the transaction.

6. Trading ahead involves a practice whereby the specialist fills an agency order through a proprietary trade for the specialist firm's proprietary account – by improperly 'stepping in front' of, or 'trading ahead' of, another agency order. Unlike interpositioning, the practice of "trading ahead" does not necessarily involve a second specialist trade for the specialist firm's proprietary account into the opposite, disadvantaged agency order. For example, in a declining market, a specialist may "trade ahead" by filling a market buy order by selling stock from the specialist firm's proprietary account in front of an agency market sell order. In so doing, the specialist would execute a trade for the proprietary account at a higher price, then fill the agency sell order *after* the proprietary trade, thereby resulting in the agency market sell order receiving a lower price as the price of the stock fell.

7. During the Relevant Period, in TXN, Fee executed hundreds of trades that constituted interpositioning, which generated thousands of dollars in profit for his firm's proprietary account at the expense of customer orders, and hundreds of trades that constituted trading ahead, which generated thousands of dollars in customer harm.

APPLICABLE LAW

Section 11(b) of the Exchange Act and Rule 11b-1 Thereunder

8. Section 11(b) of the Exchange Act and Rule 11b-1 thereunder require various limitations on the operations of specialists, including limiting a specialist's dealer transactions to those "reasonably necessary to permit him to maintain a fair and

orderly market." Section 11(b) and Rule 11b-1 permit a national securities exchange to promulgate rules that allow a member to register as a specialist and to act as a dealer. Under Rule 11b-1 if the Commission finds, after appropriate notice and opportunity for hearing, that a specialist has for any account in which he has an interest "effected transactions ... which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market," and were "not effected in a manner consistent with the rules adopted by such exchange," the Commission may order the exchange to suspend or cancel the specialist's registration. If, however, the exchange itself has suspended or canceled the specialist's registration, no further sanction shall be imposed unless the Commission finds "substantial or continued misconduct."

9. Where specialists make trades for their firm's proprietary accounts that are not "reasonably necessary to permit [such specialists] to maintain a fair and orderly market," they have violated Section 11(b) and Rule 11b-1 of the Exchange Act. The Commission has brought settled actions for sanctions under Exchange Act Section 15(b) against specialists under Section 11(b) and Rule 11b-1. See In the Matter of Albert Fried & Co. and Albert Fried, Jr., 1978 WL 196046, S.E.C. Release No. 34-15293 (Nov. 3, 1978).

10. Several NYSE rules prohibit a specialist from trading ahead of a customer order, as well as from engaging in interpositioning, and require agency orders to be matched whenever possible, consistent with a specialist's duty to maintain a fair and orderly market.

11. NYSE Rule 104 (Dealings by Specialists), which sets forth specialists' obligations, prohibits specialists from trading for their own accounts unless it is reasonably necessary to maintain a fair and orderly market. This is known as the negative obligation. Rule 104 states in relevant part: "No specialist shall effect . . . purchases or sales of any security in which such specialist is registered . . ., unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."[2]

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[2] Rule 104.10(3), which describes specialists' affirmative obligations, also expands on the negative obligation:

> Transactions on the Exchange for his own account effected by a member acting as a specialist must constitute a course of dealings reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. Transactions not part of such a course of dealings ... are not to be effected.

12. NYSE Rule 92 (Limitations on Members' Trading Because of Customers Orders) generally prohibits a member from entering a proprietary order to buy (or sell) a security while in possession of an executable buy (or sell) agency order that could be executed at the same price. During the Relevant Period, Rule 92 stated in relevant part:

> No member shall personally buy . . . any security . . . for his own account or for any account in which he is . . . interested . . . while such member personally holds or has knowledge that his member organization holds an unexecuted market order to buy such security . . . for a customer.[3]

13. Similarly, NYSE Rule 92 also applies to the specialist buying or selling a security while holding an unexecuted market buy or sell order, as well as to circumstances where the specialist holds unexecuted customer limit orders at a price that could be satisfied by the proprietary transaction effected by the specialist.

14. NYSE Rule 123B (Exchange Automated Order Routing Systems) requires specialists to cross orders received over the DOT system. Rule 123B(d) states in relevant part: "a specialist shall execute System orders in accordance with Exchange auction market rules and procedures, including requirements to expose orders to buying and selling interest in the trading crowd and *to cross orders before buying or selling from his own account.*" (Emphasis added).

15. NYSE Rule 401 requires NYSE members to "adhere to the principles of good business practice in the conduct of his or its business affairs." Similarly, NYSE Rule 476(a)(6) provides sanctions if NYSE members are adjudged guilty of "conduct or proceeding inconsistent with just and equitable principles of trade."

16. As a result of the conduct described above, Fee violated the aforementioned NYSE rules and violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

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3 Rule 92 was amended on January 7, 2002 to read in relevant part:

> [n]o member or member organization shall cause the entry of an order to buy (sell) any Exchange-listed security for any account in which such member or member organization or any approved person thereof is directly or indirectly interested (a "proprietary order"), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the cease-and-desist order agreed to in Fee's Offer.

Accordingly, it is hereby ORDERED that:

> Pursuant to Section 21C of the Exchange Act, Fee shall cease and desist from committing or causing any violations and any future violations of Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.
>
> By the Commission.

Florence E. Harmon
Acting Secretary

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

Commissioner Walter and
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 58793 / October 15, 2008

Administrative Proceeding
File Number 3-11893

In the Matter of David A. Finnerty, Donald R. Foley II, Scott G. Hunt, Thomas J. Murphy, Jr., Kevin M. Fee, Frank A. Delaney IV, Freddy DeBoer, Todd J. Christie, James V. Parolisi, Robert W. Luckow, Patrick E. Murphy, Robert A. Johnson, Jr., Patrick J. McGagh, Jr., Joseph Bongiorno, Michael J. Hayward, Richard P. Volpe, Michael F. Stern, Warren E. Turk, Gerard T. Hayes, and Robert A. Scavone, Jr. Respondents.	ORDER MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO TODD J. CHRISTIE

20 of 42

I.

On April 12, 2005, the Securities and Exchange Commission ("Commission") entered an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6), 21C and 11(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 11b-1 Thereunder ("OIP") against respondent Todd J. Christie ("Christie").

II.

Christie has submitted an Offer of Settlement ("Offer") in these administrative proceedings, 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, Christie consents to the entry of this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C Securities Exchange Act of 1934 as to Todd J. Christie, as set forth below.

III.

On the basis of this Order and Christie's Offer, the Commission finds[1] that:

FACTS

1. Christie is one of several respondents in pending administrative and cease-and-desist proceedings, file number 3-11893, who have been charged with improper trading during the period from at least 1999 through June 30, 2003 (the "Relevant Period"), while they were acting as specialists on the New York Stock Exchange ("NYSE").

2. Christie, age 44, of Morris Township, New Jersey, acted as a specialist on the NYSE at Spear, Leeds & Kellogg Specialists LLC ("Spear Leeds") from at least January 1, 1999 to approximately March 2003. Christie was a Spear Leads Chief Executive Officer during the Relevant Period.

3. During the Relevant Period charged in the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 21C and 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 thereunder, Christie acted as a specialist in International Business Machines Corp. ("IBM") (from approximately January 1999 to approximately

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

March 1999), and in AOL Time Warner ("AOL") (from approximately April 1999 to approximately May 2001, excluding July and August 2000).

4. As a specialist, Christie had an obligation to serve public customer orders over the proprietary interests of the firm with whom he was formerly employed, Spear Leeds. In his role as a specialist, Christie had a general duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from Spear Leeds' own account when those customer orders could be matched with other customer orders.

5. Interpositioning involves a two-step process that allows the specialist to generate a profit for the specialist firm from the spread between two opposite trades. Interpositioning can take various forms. In one form, the specialist purchases stock for the specialist firm's proprietary account from the customer sell order, and then fills the customer buy order by selling from the specialist firm's proprietary account at a higher price. A second form of interpositioning involves the specialist selling stock into the customer buy order, and then filling the customer sell order by buying for the specialist firm's proprietary account at a lower price. In both forms of interpositioning, the specialist participates on both sides of the trade, thereby capturing the spread between the purchase and sale prices, disadvantaging at least one of the parties to the transaction.

6. Trading ahead involves a practice whereby the specialist fills an agency order through a proprietary trade for the specialist firm's proprietary account – by improperly 'stepping in front' of, or 'trading ahead' of, another agency order. Unlike interpositioning, the practice of "trading ahead" does not necessarily involve a second specialist trade for the specialist firm's proprietary account into the opposite, disadvantaged agency order. For example, in a declining market, a specialist may "trade ahead" by filling a market buy order by selling stock from the specialist firm's proprietary account in front of an agency market sell order. In so doing, the specialist would execute a trade for the proprietary account at a higher price, then fill the agency sell order *after* the proprietary trade, thereby resulting in the agency market sell order receiving a lower price as the price of the stock fell.

7. During the Relevant Period, in IBM and AOL, Christie executed hundreds of trades that constituted interpositioning, which generated thousands of dollars in profit for his firm's proprietary account at the expense of customer orders, and hundreds of trades that constituted trading ahead, which generated thousands of dollars in customer harm.

APPLICABLE LAW

Section 11(b) of the Exchange Act and Rule 11b-1 Thereunder

8. Section 11(b) of the Exchange Act and Rule 11b-1 thereunder require various limitations on the operations of specialists, including limiting a specialist's dealer transactions to those "reasonably necessary to permit him to maintain a fair and orderly market." Section 11(b) and Rule 11b-1 permit a national securities exchange to promulgate rules that allow a member to register as a specialist and to act as a dealer. Under Rule 11b-1 if the Commission finds, after appropriate notice and opportunity for hearing, that a specialist has for any account in which he has an interest "effected transactions ... which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market," and were "not effected in a manner consistent with the rules adopted by such exchange," the Commission may order the exchange to suspend or cancel the specialist's registration. If, however, the exchange itself has suspended or canceled the specialist's registration, no further sanction shall be imposed unless the Commission finds "substantial or continued misconduct."

9. Where specialists make trades for their firm's proprietary accounts that are not "reasonably necessary to permit [such specialists] to maintain a fair and orderly market," they have violated Section 11(b) and Rule 11b-1 of the Exchange Act. The Commission has brought settled actions for sanctions under Exchange Act Section 15(b) against specialists under Section 11(b) and Rule 11b-1. See In the Matter of Albert Fried & Co. and Albert Fried, Jr., 1978 WL 196046, S.E.C. Release No. 34-15293 (Nov. 3, 1978).

10. Several NYSE rules prohibit a specialist from trading ahead of a customer order, as well as from engaging in interpositioning, and require agency orders to be matched whenever possible, consistent with a specialist's duty to maintain a fair and orderly market.

11. NYSE Rule 104 (Dealings by Specialists), which sets forth specialists' obligations, prohibits specialists from trading for their own accounts unless it is reasonably necessary to maintain a fair and orderly market. This is known as the negative obligation. Rule 104 states in relevant part: "No specialist shall effect . . . purchases or sales of any security in which such specialist is registered . . ., unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."[2]

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[2] Rule 104.10(3), which describes specialists' affirmative obligations, also expands on the negative obligation:

> Transactions on the Exchange for his own account effected by a member acting as a specialist must constitute a course of dealings

12. NYSE Rule 92 (Limitations on Members' Trading Because of Customers Orders) generally prohibits a member from entering a proprietary order to buy (or sell) a security while in possession of an executable buy (or sell) agency order that could be executed at the same price. During the Relevant Period, Rule 92 stated in relevant part:

> No member shall personally buy . . . any security . . . for his own account or for any account in which he is . . . interested . . . while such member personally holds or has knowledge that his member organization holds an unexecuted market order to buy such security . . . for a customer.[3]

13. Similarly, NYSE Rule 92 also applies to the specialist buying or selling a security while holding an unexecuted market buy or sell order, as well as to circumstances where the specialist holds unexecuted customer limit orders at a price that could be satisfied by the proprietary transaction effected by the specialist.

14. NYSE Rule 123B (Exchange Automated Order Routing Systems) requires specialists to cross orders received over the DOT system. Rule 123B(d) states in relevant part: "a specialist shall execute System orders in accordance with Exchange auction market rules and procedures, including requirements to expose orders to buying and selling interest in the trading crowd and *to cross orders before buying or selling from his own account.*" (Emphasis added).

15. NYSE Rule 401 requires NYSE members to "adhere to the principles of good business practice in the conduct of his or its business affairs." Similarly, NYSE

> reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated. Transactions not part of such a course of dealings ... are not to be effected.

3 Rule 92 was amended on January 7, 2002 to read in relevant part:

> [n]o member or member organization shall cause the entry of an order to buy (sell) any Exchange-listed security for any account in which such member or member organization or any approved person thereof is directly or indirectly interested (a "proprietary order"), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price.

Rule 476(a)(6) provides sanctions if NYSE members are adjudged guilty of "conduct or proceeding inconsistent with just and equitable principles of trade."

16. As a result of the conduct described above, Christie violated the aforementioned NYSE rules and violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the cease-and-desist order agreed to in Christie's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, Christie shall cease and desist from committing or causing any violations and any future violations of Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-58785; File No. S7-31-08]

RIN 3235-AK23

DISCLOSURE OF SHORT SALES AND SHORT POSITIONS BY INSTITUTIONAL INVESTMENT MANAGERS

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; Request for comments.

SUMMARY: The Commission is adopting an interim final temporary rule requiring certain institutional investment managers to file information on Form SH concerning their short sales and positions of section 13(f) securities, other than options. The new rule extends the reporting requirements established by our Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008, with some modifications. The extension will be effective until August 1, 2009. Consistent with the Orders, the rule requires an institutional investment manager that exercises investment discretion with respect to accounts holding section 13(f) securities having an aggregate fair market value of at least $100 million to file Form SH with the Commission following a calendar week in which it effected a short sale in a section 13(f) security, with some exceptions.

DATES: Effective Date: §§ 240.10a-3T, 249.326T and temporary Form SH are effective from October 18, 2008 until August 1, 2009.

Compliance Dates: An institutional investment manager that is required to file a Form SH report on October 24, 2008 or October 31, 2008, must comply with Rule 10a-3T, except that it:

- may exclude disclosure of short positions reflecting short sales before September 22, 2008 from the Form SH report filed on either or both of those dates. An institutional investment manager choosing to exclude these short sales effected before September 22 is not required to report short positions otherwise reportable if the short position in the section 13(f) security constitutes less than one-quarter of one percent of that class of the issuer's securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any current report subsequent thereto, filed with the Commission pursuant to the Securities Exchange Act of 1934, unless the manager knows or has reason to believe that the information contained therein is inaccurate, and the fair market value of the short position in the section 13(f) security is less than $1,000,000; and
- does not have to file Form SH in XML format in accordance with the special filing instructions posted on the Commission's website. Instead, the institutional investment manager may file Form SH on EDGAR in the same manner as the form was filed pursuant to the Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008.

Comment Date: Comments on the interim final temporary rule should be received on or before [insert date 60 days after publication in 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. Please include File Number S7-31-08 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-31-08. 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/final.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 publicly available.

FOR FURTHER INFORMATION CONTACT: Steven Hearne, at (202) 551-3430, in the Division of Corporation Finance, Marlon Paz, at (202) 551-5756, in the Division of Trading and Markets, or Stephan N. Packs, at (202) 551-6865, in the Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3010.

SUPPLEMENTARY INFORMATION: The Commission is adopting temporary Rule 10a-3T and Temporary Form SH (Form SH) under the Securities Exchange Act of 1934[1] as an interim temporary final rule. We are soliciting comments on all aspects of the interim temporary final rule and Form SH. We will carefully consider the comments that we receive and intend to address them in a subsequent release.

I. Background

Recently, we have become concerned that there is a substantial threat of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. These concerns are evidenced by our recent publication of Emergency Orders under Section 12(k) of the Exchange Act in July[2] and September of this year.[3] In these Orders, we noted our concerns about the possible unnecessary or artificial price movements that may be based on unfounded rumors and may be exacerbated by short selling.

Short selling involves a sale of a security that the seller does not own or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.[4] Short sales normally are settled by the delivery of a security borrowed by or on behalf of the seller. Regulation SHO, which became fully effective on January 3,

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1 15 U.S.C. 78 et seq.

2 Release No. 34-58166 (July 15, 2008) [73 FR 42379] (imposing borrowing and delivery requirements on short sales of the equity securities of certain financial institutions).

3 Release Nos. 34-58592 (Sept. 18, 2008) [73 FR 55169] (temporarily prohibiting short selling in the publicly traded securities of certain financial institutions), 34-58591 (Sept. 18, 2008) [73 FR 55175] (requiring institutional investment managers to report short sales activities) and 34-58572 (Sept. 17, 2008) [73 FR 54875] (imposing enhanced delivery requirements on sales of all equity securities).

4 17 CFR 242.200(a).

2005, sets forth the regulatory framework governing short sales.[5] Among other things, Regulation SHO imposes a close-out requirement to address failures to deliver stock on trade settlement date and to target potentially abusive short selling in certain equity securities.

As adopted, Regulation SHO included two major exceptions to the close-out requirement: the "grandfather" provision and the "options market maker" exception. Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continued to observe threshold securities with fail to deliver positions that are not being closed out under existing delivery and settlement requirements, effective on October 15, 2007, we adopted an amendment to Regulation SHO that eliminated the "grandfather" exception to Regulation SHO's close-out requirement.[6] The options market maker provision excepted any fail to deliver position in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security. On September 17, 2008, we adopted and made immediately effective an amendment to Rule 203(b)(3) of Regulation SHO to eliminate the options market maker exception to the rule's close-out requirement.[7]

On September 18, 2008, the Commission issued an Emergency Order pursuant to Section 12(k)(2) of the Exchange Act[8] requiring institutional investment managers to report information concerning their short sales of section 13(f) securities on a weekly

5 17 CFR 242.200(a).

6 See Release No. 34-56212 (Aug. 7, 2007) [72 FR 45544].

7 See Release No. 34-58572 (Sept. 17, 2008).

8 15 U.S.C. 78l(k)(2).

basis.[9] We amended the Order on September 21, 2008 to clarify certain technical issues and the public availability of the information provided by the institutional investment managers.[10] On October 2, 2008, we extended the Order's effectiveness through October 17, 2008, and stated that the Forms SH filed under the Order would remain nonpublic to the extent permitted by law.[11]

Under the terms of the Emergency Orders, institutional investment managers that exercise investment discretion with respect to accounts holding securities described in Rule 13f-1(c) under the Exchange Act[12] that have an aggregate fair market value of at least $100,000,000, and effect short sales of those securities generally are required to file Form SH with the Commission on a weekly basis. The Form SH filing currently must be made on the first business day of each calendar week following a week in which the institutional investment manager has effected short sales with respect to any section 13(f) security that is not an option.[13] With respect to each applicable section 13(f) security, the Form SH filing must identify the issuer and CUSIP number of the relevant security and reflect the manager's start of day short position, the number and value of securities sold short during the day, the end of day short position, the largest intraday short position, and the time of the largest intraday short position.

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9 Release No. 34-58591.

10 Release No. 34-58591A (Sept. 21, 2008) [73 FR 58987].

11 Release No. 34-58724 (Oct. 2, 2008) [73 FR 58987-01]. Release 34-58724, together with Release 34-58591 and 34-58591A are collectively referred to as the Emergency Orders.

12 17 CFR 240.13f-1(c).

13 Our discussion here and elsewhere in the release regarding the need to disclose short sales and short positions assumes that the reporting exception, which is described in Section II.A.3, does not apply.

To make clear that continuous reporting of open short positions previously reported on Form SH was not required when no new short sales had been effected during the calendar week covered by the next Form SH filing due to be filed, the Emergency Orders stated that no Form SH filing is required when no short sales of a section 13(f) security have been effected since the previous filing of a Form SH.[14] Further, an institutional investment manager need not report certain information regarding short sales and positions that otherwise would be reportable on Form SH if:

- The short sale or position in the section 13(f) security constitutes less than one-quarter of one-percent of that class of the issuer's section 13(f) securities issued and outstanding, as reported on the issuer's most recent annual or quarterly report, and any subsequent current report, filed with the Commission pursuant to the Exchange Act, unless the manager knows or has reason to believe that the information contained therein is inaccurate; and
- The fair value market of the short sale or position in the section 13(f) security is less than $1,000,000.

II. Purposes of the Interim Final Temporary Rule

As explained in the Emergency Orders requiring Form SH filings, and other emergency orders under Section 12(k) of the Exchange Act,[15] we are concerned by sudden and excessive fluctuation of securities prices and disruptions in the fair and

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14 Similarly, under the Emergency Orders no Form SH filing is required when all short sales of section 13(f) securities that have been effected since the last day of the prior reporting period for which a Form SH was due qualify for the reporting exception.

15 See also Release Nos. 34-58166 (July 15, 2008) [73 FR 42837] and 34-58572 (Sept. 17, 2008) [73 FR 58698].

orderly functioning of the securities markets. We are concerned about possible unnecessary or artificial price movements that may be based on unfounded rumors and may be exacerbated by short selling.

We note that regulators in several foreign jurisdictions also have adopted rules requiring disclosure of short sales and net short positions. For example, the Netherlands Authority for the Financial Markets (AFM) requires daily disclosure to the AFM of net short positions greater than 0.25% of the capital of financial institutions listed on the Euronext Amsterdam stock exchange. The UK Financial Services Authority (FSA) requires daily disclosure to UK exchanges of net short positions greater than 0.25% of the ordinary stock of UK financial institutions listed in the United Kingdom.

The Commission believes that requiring the filing of the information on Form SH will provide useful information to the staff to analyze the effects of our rulemakings relating to short sales and in evaluating whether our current rules are working as intended, particularly in times of financial stress in our markets. The reports will supply the Commission with important information about the size and changes in short sales of particular issuers by particular investors. That information will be available to the Commission to consider when questions about the propriety of certain short selling occur.

Because of these concerns, we are extending the requirements to file the Forms SH until August 1, 2009 with the following modifications to the reporting requirements:

- Beginning on October 18, 2008, the Form SH weekly filing deadline will be the last business day of the calendar week following a calendar week in which short sales are effected instead of the first business day as required by the Emergency

Orders. This change will provide filers with additional time to gather and verify the necessary information and file the forms.

- Form SH filers will no longer be required to disclose the value of the securities sold short (currently column 5 of Form SH), the largest intraday short position (currently column 7 of Form SH) and the time of day of the largest intraday short positions (currently column 8 of Form SH). We understand that some of this information has been difficult for filers to obtain.
- Form SH filers will be required to report all short positions, including short positions effected prior to September 22, 2008, when reporting data elements 5, 6 and 7, Short Position (Start of Day), Number of Securities Sold Short (Day) and Short Position (End of Day). We believe this additional data will assist with our goals of tracking short sale activity.
- The threshold for reporting short sales or positions will be raised from a fair market value of $1 million to a fair market value of $10 million. We have raised this threshold due to the new requirement to disclose pre-September 22, 2008 short sales and positions.[16]
- Filers will be required to submit an XML tagged data file to the Commission providing the requested data. This new requirement will facilitate the review of the filed data by the Commission staff.

III. Interim Final Temporary Exchange Act Rule 10a-3T and Form SH

We are adopting interim final temporary Exchange Act Rule 10a-3T (Rule 10a-3T) to require institutional investment managers to continue filing Form SH in a form

16 Under the Emergency Orders, institutional investment managers did not have to disclose short sales effected, and positions held, prior to September 22, 2008.

that is substantially similar to that required by the Emergency Orders. Adoption of the interim final temporary rule, which will be effective immediately and will continue in effect until August 1, 2009, will facilitate our review of our regulation of short sales. We have included several requests for comment in this release. We will consider public comments on Rule 10a-3T and Form SH in determining whether we should revise the interim final temporary rule or Form SH in any respect, as well as whether we should promulgate a longer-term or permanent short sale reporting requirement upon expiration of Rule 10a-3T and Form SH on August 1, 2009. We intend to address any comments received in a subsequent release.

A. Description of Rule 10a-3T

Exchange Act Rule 10a-3T requires certain institutional investment managers that exercise investment discretion[17] with respect to accounts holding section 13(f) securities[18] to file a nonpublic Form SH on a weekly basis if they have effected short sales with respect to a section 13(f) security during the reporting period preceding the due date of the filing.

1. Institutional Investment Managers Required to Report Short Sales

Rule 10a-3T requires institutional investment managers to keep track of certain short sale transactions and file Form SH to report them. The rule requires the filing of Form SH by those institutional investment managers that: (1) as of the end of the most

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17 For purposes of this rule, the term "investment discretion" has the same meaning as in Rule 13f-1(b) under the Exchange Act. [17 CFR 240.13f-1(b)].

18 The term "section 13(f) securities" is defined in Rule 13f-1(c) under the Exchange Act [17 CFR 240.13f-1(c)] to include securities of a class described in Section 13(d)(1) of the Exchange Act [15 U.S.C. 78m(d)(1)] that are admitted to trading on a national securities exchange or quoted on the automated quotation system of a registered securities association. In determining what classes of securities are section 13(f) securities, an institutional investment manager may rely on the Official List of Section 13(f) Securities published by the Commission available at http://www.sec.gov/divisions/investment/13flists.htm.

recent calendar quarter, filed, or were required to file, a Form 13F for the calendar quarter; and (2) during a Sunday to Saturday calendar week effected a short sale in a section 13(f) security other than options.[19] The manager is required to file a Form SH report with the Commission on the last business day of the ensuing calendar week. By limiting the Form SH reporting requirement to institutional investment managers that are required to file Form 13F, we subject only those institutional investment managers that exercise investment discretion with respect to accounts holding section 13(f) securities that have an aggregate fair market value on the last trading day of any month of the previous calendar year of at least $100 million to the Form SH reporting requirement.[20]

We are applying the rule only to Form 13F filers because they exercise discretion over large accounts that have significant potential to affect the markets. In addition, these filers already are subject to Exchange Act reporting and in most instances, the Emergency Orders, and therefore are familiar with using the Commission's EDGAR system to submit filings. In addition, the Form SH reporting requirement applies only to section 13(f) securities, which include equity securities of a class described in section 13(d)(1) of the Exchange Act that are admitted to trading on a national securities exchange or quoted on the automated quotation system of a registered securities association, because this is a useful and tested term that is well-suited to capture the information we are seeking.

Request for Comment

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19 As adopted, the rule differs from the requirement of the Order which applied to institutional investment managers that were required to file Form 13F for the quarter ended June 30, 2008. Because the temporary rule will be in effect until August 1, 2009, the temporary rule refers instead to the previous calendar quarter.

20 See 17 CFR 240.13f-1(a)(1).

- Rule 10a-3T limits reporting of short sales and short positions to institutional investment managers that are required to file Form 13F. Should we continue to require Form SH reporting by these institutional investment managers? Should we require only a subset of these institutional investment managers to file Form SH reports? If so, how should we limit the type of institutional investment manager that we require to file Form SH? Should we instead require a different set of persons to file Form SH? Are there categories of persons that conduct a significant amount of short sales but who are not required to submit Form SH because they are not institutional investment managers required to file Form 13F? If so, which categories of short sellers should be subject to Form SH reporting? Would it be appropriate to require anyone who conducts short sales or has short positions in excess of specified thresholds, such as those in Rule 10a-3T(b)(2)(ii), to report?
- Are there other, better ways to collect information about short sales than by requiring Form SH?
- Should we require short sellers to keep current detailed books and records of their short sale activities and their short positions, of the sort required under Rule 17a-3(a)(6) under the Exchange Act?[21] If so, should we require short sellers to retain the name of the broker, the number of shares, the price, the issuer name, the time and date of entry of the order, the time and date of execution of the order, the type of order (limit or market), the locate source or exception to locate claimed, the contact at the locate, the time and date when the locate was received, the amount

[21] 17 CFR 240.17a-3(a)(6).

of shares located, the time and date of the borrow, the number of shares borrowed, the source from which they were borrowed, and where the borrowed shares are located? Should we require other information be maintained?

- In the alternative, or in addition, should we require all short sellers to publicly provide a notice filing when their short sale activity or positions cross a specific threshold that would be deemed significant? If so, what information should the notice filing contain? If a notice filing is required, should it be filed with us on a nonpublic basis? Would there be any concerns about publicly filing such a notice? Would such a notice filing provide useful information to investors? Would requiring all short sellers to keep detailed records of their short sale activities and filing when necessary a notice filing relating to those activities raise any other concerns, such as concerns about the potential costs? In the alternative, should we instead require short sellers to produce books and records upon request from the Commission?

2. Short Sales and Short Positions Required to be Reported

Rule 10a-3T requires an institutional investment manager to report short sales and short positions, as defined in Rule 200 of Regulation SHO. Rule 200 defines a short sale to mean any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.[22] For purposes of Rule 10a-3T, a short position is the aggregate gross short sales of an issuer's section 13(f) securities (excluding options), less purchases to close out a short sale in the same issuer. The Form SH short position is not net of long position in

[22] 17 CFR 242.200.

the issuer. If a person that has loaned a security to another person sells the security and a bona fide recall is initiated within two business days after trade date, the person that has loaned the security is deemed to own the security for purposes of Rule 200(g)(1) and Rule 200(b) of Regulation SHO, and such sale will not be treated as a short sale.[23] Rule 10a-3T is intended to broadly require institutional investment managers to account for their short sales.

Options and short sales of options on section 13(f) securities are not required to be reported on Form SH. However, certain transactions that involve options are required to be reported.[24] For example, if an institutional investment manager exercises a put and is net short pursuant to Rule 200(c) of Regulation SHO, the resulting transaction is a short sale and must be reflected on Form SH. Similarly, if the institutional investment manager effects a short sale as a result of assignment to it as a call writer, upon exercise, the resulting transaction is a short sale and must be reflected on Form SH.

Request for Comment

- Rule 10a-3T is limited to reporting on short sales and short positions of section 13(f) securities, other than options. Should we continue to require disclosure about short sales of these section 13(f) securities? Should we limit the securities that institutional investment managers are required to report on to a subset of these securities, such as equity securities of financial institutions? Would it be more appropriate for the Form SH reporting requirement to cover all publicly

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23 For staff guidance regarding how sales of loaned but recalled securities should be treated for purposes of the Emergency Orders, see the Division of Trading and Market Guidance Regarding Sale of Loaned but Recalled Securities available at http://www.sec.gov/divisions/marketreg/loanedsecuritiesfaq.htm.

24 Short sales resulting from the exercise of option contracts are reportable as of the date of the exercise.

traded equity securities regardless of whether they are listed on a national securities exchange or quoted on the automated quotation system of a registered securities association? Should we require reporting on Form SH for transactions relating to any equity security of a company reporting under the Exchange Act?

- Rule 10a-3T requires reporting of the start of day short position, the gross number of securities sold short during the day and the end of day short position. Does requiring reporting of this information have the effect of reducing manipulative behavior and other improper conduct by short sellers? Do these categories of information provide the most useful data for analyzing short selling activities and combating market manipulation? If not, are there other benefits that Form SH information will provide? Are there other categories of information that we should require that would be useful to our objectives, such as transaction audit trails or the portion of the number of securities sold short in foreign markets?
- Do the definitions of the terms short sale and short position that we use in Rule 10a-3T adequately capture the types of transactions on which the Commission should focus? Should we use definitions for the terms short sale or short position in Rule 10a-3T that are different from the Regulation SHO definitions? If so, how should we define these terms?
- How can we best address the risk that managers may try to evade reporting by conducting short sales through synthetic instruments or through third parties that are not required to report on Form SH? Should we require disclosure of these transactions as well? Should we amend the rule to require filers to report any synthetic arrangements that function as short sales and provide Form SH

information for those positions and identify the parties to those transactions? How would we define or describe these transactions? Should we require any short seller that is entering the short to hedge a synthetic position entered into with another party to identify the other party in Form SH?

- Should we revise Rule 10a-3T to require disclosure of options and short sales of options? Should Rule 10a-3T require disclosure of other financial instruments such as single stock futures?
- Rule 10a-3T requires information to be reported to the Commission. Should the rule require this information to be provided to the self regulatory organizations? If so, which self-regulatory organizations should receive this information? Should we work with the exchanges and self-regulatory organizations to capture this information? Would these organizations be well equipped to monitor the data that we are requesting?
- Should we consider harmonizing our short sale reporting and regulation with foreign regulators? Would it be appropriate to require similar short sale reporting to that implemented by the FSA in the United Kingdom?[25] What aspects would be more or less appropriate?

3. Exceptions to the Filing and Reporting Requirements

Rule 10a-3T does not require an institutional investment manager to file a Form SH to report short sales and positions if:[26]

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25 See information on the short selling instruments issued in September 2008 at the Financial Services Authority Web site at http://www.fsa.gov.uk/pages/Library/Policy/Handbook/short-selling.shtml.

26 Unlike the requirements under the Emergency Orders, the rules we adopt today require short sales or positions effected prior to September 22, 2008 to be reported.

- The institutional investment manager has not effected any short sales of section 13(f) securities during the reporting period covered by the Form SH due to be filed; or
- On each calendar day during the calendar week, the start of day short position, the gross number of securities sold short during the day and the end of day short position constitute less than one-quarter of one percent of that class of the issuer's section 13(f) securities issued and outstanding as reported on the issuer's most recent annual, quarterly or current report filed with the Commission pursuant to section 13 of the Exchange Act, unless the manager knows or has reason to believe the information contained therein is inaccurate and the fair market value of the start of day short position, the gross number of securities sold short during the day and the end of day short position is less than $10,000,000.[27]

Once a determination is made that a Form SH filing is required, Rule 10a-3T permits an institutional investment manager to disclose in the appropriate data element its reliance on this exception with respect to information otherwise required to be reported. The institutional investment manager may disclose "N/A" in the appropriate data element to report the number of securities sold short or corresponding information regarding the short position in that class where the data element falls below the reporting threshold. The exception limits the substantive disclosure required on Form SH to significant short sales and positions that have the potential to materially affect the price of the underlying securities. This limitation is designed to strike a balance between the burden of

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[27] For purposes of determining whether the $10,000,000 threshold is met, the manager should multiply the number of shares the manager sold short that day by the market price as of the time of the close of trading at the NYSE on that day.

compiling and providing the information to the Commission and the need for information about short sales to be available to the Commission.

We are clarifying in accordance with staff guidance provided in conjunction with the Emergency Orders that institutional investment managers may act as conduits for customer orders by handling such orders on a "riskless principal"[28] basis in the following scenarios, which may result in the broker-dealer effecting a short sale: (i) a broker-dealer receives an order to sell a section 13(f) security from a customer who is net long on the securities being sold, and the broker-dealer then seeks to execute that order, either in whole or in part, by selling the section 13(f) security as riskless principal, and the broker-dealer has an overall net short position in such section 13(f) security; or (ii) a broker-dealer receives an order to buy a section 13(f) security from a customer, and the broker-dealer then seeks to execute that order, either in whole or in part, by purchasing the section 13(f) security as riskless principal, and then selling the section 13(f) security to the customer, and the broker-dealer has an overall net "short" position in such section 13(f) security. In both scenarios, the short sales need not be reported by the broker-dealer on Form SH.

We are eliminating the "grandfather" provision that was included in the Form SH filing conditions set forth in the Emergency Orders. The Emergency Orders did not require disclosure of existing or outstanding short positions in section 13(f) securities held before the September 22, 2008 effective date of the initial order. This grandfather provision was established primarily to address concerns about the public disclosure of

[28] A "riskless principal" transaction is generally described as trades in which, after receiving an order to buy (or sell) from a customer, the broker-dealer purchases (or sells) the security from (or to) another person in a contemporaneous offsetting transaction. See Exchange Act Rule 10b-10(a)(2)(ii)(A) [17 CFR 240.10b-10(a)(2)(ii)(A)]; Release No. 34-33743 (Mar. 9, 1994) at n.11.

institutional investment managers' pre-existing short positions before we indicated that Form SH filings would be made on a nonpublic basis. One of the commenters on the Emergency Orders noted that a consequence of the grandfather provision is that some Form SH filers will have to keep two sets of books until all of the pre-September 22 positions are cleared out.[29]

Under Rule 10a-3T, Form SH filers will be required to report all short positions, including short positions effected prior to September 22, 2008, when reporting data elements 5, 6 and 7, Short Position (Start of Day), Number of Securities Sold Short (Day) and Short Position (End of Day) on Form SH. We believe that the additional data about the pre-September 22 positions will improve our efforts to analyze short sale activity.

In connection with elimination of the grandfather provision, we are revising the exception to the Form SH filing requirements. Under the Emergency Orders, Form SH filers are not required to report short sales or short positions otherwise reportable if: the short sale or short position in the section 13(f) security constitutes less than one-quarter of one per cent of that class of the issuer's section 13(f) securities issued and outstanding, as reported on the issuer's most recent Exchange Act report; and the fair market value of the short sale or short position in the section 13(f) security is less than $1 million. We are raising the threshold for filing and reporting short sales or short positions in a class of section13(f) securities other than options from a fair market value of $1 million to a fair market value of $10 million primarily due to the new requirement for institutional investment managers to report information about their pre-September 22 short positions.

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29 See letter from the Securities Industry and Financial Markets Association dated October 9, 2008 available in file No. S7-24-08.

In addition, we note that the threshold is intended to ensure that small percentage positions that comprise large monetary positions are reported, and we believe that $10 million more suitably addresses this concern.

An institutional investment manager that is required to file a Form SH report on October 24, 2008 or October 31, 2008 may exclude disclosure of short positions reflecting short sales effected before September 22, 2008 from the Form SH report filed on either or both of those dates. However, if the manager excludes such disclosure, the relevant fair market threshold for reporting short sales or positions is the $1 million threshold.

Request for Comment

- Is the exception in Rule 10a-3T to Form SH reporting of short sales that fall below the specified thresholds appropriate? If so, are the thresholds set at appropriate levels, or should they be higher or lower? What threshold would be appropriate? Should we use 5% as in Regulation 13D[30] or is a smaller threshold, such as 2.5%, more appropriate? If you suggest a different type of exception to Form SH reporting, please describe the exception that you think is appropriate.
- Is the reporting exception in Rule 10a-3T for "riskless principal" transaction appropriate? If not, why not and what would be the best way to address "riskless principal" transactions in the rule?
- Should we continue to use a significance test that couples a percentage of shares outstanding threshold with a fair market value threshold? Should the percentage and market value thresholds be combined or should they be separate standards? If

[30] 17 CFR 240.13d-1 et seq.

separate, what level should each be set at? Would $1 million or $10 million be appropriate? Would 1%, 2.5% or 5% be appropriate? Should we instead adopt a threshold that is tied to the number of shares sold short or some other standard?

- As adopted, a manager is required to report its short sales and short positions. However, managers often take short positions in order to hedge the risk on long positions in which they invest and not for speculative purposes. Should we develop an exemption that would permit managers to avoid reporting of hedging short positions or in the alternative require additional information that explains the purposes of various short positions? If so, how would we best develop the exemption or the request for additional information and how would we define hedging transactions? Would such an exemption be useful? Would it subsume the purpose of the rule?

4. Transition and Expiration Dates of Rule 10a-3T

As noted above, the Commission remains concerned by sudden and excessive fluctuation of securities prices and disruptions in the fair and orderly functioning of the securities markets. We are adopting this temporary rule to continue the reporting obligations established in our Emergency Orders as modified. For the reasons those Orders were adopted and for the reasons explained in this release, no gap between the reporting obligations of the Emergency Orders and the obligations established by this rule should exist. In addition, we received a variety of comments from the public about the Emergency Orders, which were valuable in developing this interim temporary final rule. As a result, this rule is immediately effective.

In order to assist with the transition, institutional investment managers that are required to file a Form SH report on October 24, 2008 or October 31, 2008, must comply with Rule 10a-3T, except that they may exclude disclosure of short positions reflecting short sales before September 22, 2008 from the Form SH report filed on either or both of those dates. An institutional investment manager may choose to exclude these short sales effected before September 22 if the short position in the section 13(f) security constitutes less than one-quarter of one percent of that class of the issuer's securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any current report subsequent thereto, filed with the Commission pursuant to the Exchange Act, unless the manager knows or has reason to believe that the information contained therein is inaccurate, and the fair market value of the short position in the section 13(f) security, as of September 22, 2008, was less than $1,000,000. In addition, institutional investment managers do not have to file Form SH in XML format in accordance with the special filing instructions posted on the Commission's website for their Form SH reports on October 24, 2008 or October 31, 2008. Instead, the institutional investment manager may file Form SH on EDGAR in the same manner as the form was filed pursuant to the Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008.

Subsequently, beginning with the calendar week ending November 1, 2008, institutional investment managers are required to report as specified in Rule 10a-3T and the filer instructions as to the assembly of the EDGAR submission provided on the Commission's Web site at http://www.sec.gov/info/edgar/ednews/formshsubmission.htm or in a future update of the EDGAR Filer Manual. Rule 10a-3T will expire and cease to be effective on August 1, 2009 unless we act to continue or revise the rule and extend the effective date.

Request for Comment

- How long should institutional investment managers be required to file Form SH reports with the Commission? Is the period extending until August 1, 2009 that we are adopting appropriate? Should we require Form SH reporting beyond August 1, 2009?

B. Form SH

1. Timing and nonpublic nature of Form SH

Rule 10a-3T requires institutional investment managers to report certain short sales to the Commission on Form SH. Under Rule 10a-3T, institutional investment managers must file Form SH on the last business day of each calendar week following a week in which the institutional investment manager has effected certain short sales with respect to any section 13(f) security that is not an option.[31]

This is a change from the Form SH filing deadline set forth in the Emergency Orders which required Form SH to be filed on the first business day of each calendar week immediately following a week in which the institutional investment manager effected certain short sales. This change will provide filers with additional time to gather, verify and file the data, decreasing the burden on the filers without affecting the efficacy of the information to the staff.

As we explained in our October 2008 Order, we are concerned that publicly available Form SH data could give rise to additional, imitative short selling. Accordingly

[31] The Form SH is required to be filed electronically on the Commission's EDGAR system on or before 5:30 p.m. Eastern Time on the last business day of the calendar week.

Rule 10a-3T states that all Forms SH filed with the Commission will be nonpublic to the extent permitted by law. The Freedom of Information Act provides at least two exemptions under which the Commission has authority to withhold the information.[32] A Form SH filer should not submit a confidential treatment request to the Commission. A Form SH filer must label its Form SH as non-public, as required by the instructions to the form.

Request for Comment

- Form SH requires detailed reports regarding institutional investment managers' significant short positions in section 13(f) securities. Are there better ways for the Commission to gather short selling information and address our concerns than by using Form SH? Are the detailed reports required on Form SH appropriate? Is there any information that should be required in, or deleted from, the requirements of the Form?
- When requiring reporting of short positions, should we generally only require reporting of new positions, or should we require reporting of all short positions? Does requiring reporting of all short positions create significant additional burdens on filers? If so, what burdens and how can they best be addressed?
- Form SH requires filers to report the short position at the start of the day, the aggregate number of securities sold short on that day, and the short position at the end of the day. Is this information sufficient to provide an adequate understanding of the filer's short sale activity during the day? Should we require

32 The Freedom of Information Act ("FOIA") Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." FOIA Exemption 8 provides an exemption for matters that are "contained in or related to

filers to report their net long and short positions in addition to the information already required? Is it sufficient to simply track the net short positions and not to report the start and end of day positions and the aggregate activity?

- As adopted, Form SH no longer requires reporting of the daily value of securities sold short, the largest intraday short position and the time of day of that short position. We understand that some institutional investment managers have had significant difficulty identifying the largest intraday short position and the time of day of that short position. This information may be helpful in identifying manipulative short selling. How difficult is it for filers to track and report this information? Should we require filers to report this information? Is there an alternative way to track this kind of information and better identify when manipulative short selling may be taking place?
- Rule 10a-3T provides that the information required by Form SH shall remain nonpublic to the extent permitted by law. Institutional investment managers have expressed concern about making this information public. Should the information required by Form SH be publicly reported? Would concerns about public reporting be alleviated if there was a delay in filing the information, such as a delay of 10 days, or 45 days after the end of a quarter in which the transaction occurred, similar to the 45-day deadline for Form 13F filings? Would concerns be alleviated if the information was reported by the institutional investment manager on a nonpublic basis, but made public after a delay on an issuer basis?

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examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."

- If the Form SH remains nonpublic, what is the best way to require filers to report the Form SH information to the Commission? Is EDGAR the best vehicle for reporting Form SH information to the Commission? If not, what vehicle would be superior and why?
- We are permitting institutional investment managers to provide the information required by Form SH on the last business day following a calendar week in which the institutional investment manager effected a short sale. Are there concerns with permitting institutional investment managers with extra time to provide the information to the Commission? Is the extra time sufficient time to address concerns about the need for more time to be able to provide the information in a timely fashion? Should we change the weekly reporting period so it is not based on a calendar week?
- Institutional investment managers are required to file Form SH for any week during which they make a reportable short sale. Is it appropriate to require the filing of Form SH on a weekly basis? Should we require the filing to be made more frequently, such as daily? Should we require the filing less frequently, such as bi-weekly, monthly or quarterly, to reduce the filing burden? Would we be able to capture short selling information as effectively if Form SH reports were required to be filed less frequently?

2. Form SH

Under the Emergency Orders, Form SH may be filed in ASCII or HTML. We are adopting rules that require that short sale and position information to be filed in XML tagged data format and additional identification within the data file. By requiring reporting in XML, the Commission staff will be able to more easily analyze the data that we receive. Based on our experience with reporting under the Emergency Orders, we are reducing the data that institutional investment managers are required to report to the Commission by removing the requirement that managers report the value of securities sold short during the day, the largest intraday short position and the time of day of the largest intraday short position.

We understand that some filers have found it difficult to obtain and burdensome to track and report the largest intraday short position disclosure, and the time thereof. We are no longer requiring disclosure of the value of securities sold short during the day as our staff has the ability to perform this calculation without the disclosure from the institutional investment manager.

There are three Form SH report types: Form SH Entries Report, Form SH Notice and Form SH Combination Report. An Entries Report is filed if all of the information that an institutional investment manager is required to report is included in the Form SH filing; a Notice is filed if all of the information that a manager is required to include in the XML tagged data file is reported by another Manager; a Combination Report is filed if a portion of the manager's entries are filed in the manager's report and a portion are reported by another manager. When filing a Form SH Notice or Combination Report, the manager is required to disclose the other managers that are reporting for the manager.

Rule 10a-3T requires filers to format the Form SH data differently than under the Emergency Orders, but will similarly include:

- disclosure of the time period of the report;
- an indication of whether the report is an amendment;

- the name and address of the institutional investment manager;
- a representation by the signer;
- a signature block for the person signing the form;
- an indication of the report type;
- a list of any other managers reporting for the manager filing the report;
- the total number of transactions reported;
- a list of other managers for whom the Form SH is filed; and
- the number of other included managers.[33]

In addition, the Form SH will include, where applicable, an XML tagged data file that provides much of the information that was previously required by the Emergency Orders to be included in the Information Table. The XML tagged data file will provide the information regarding short sales, including:

- the date;
- the Central Index Key (CIK) of the filer;
- the name of the issuer;
- the CUSIP of the issuer;
- the short position at the start of the day;
- the number of securities sold short on that day; and
- the short position at the end of the day.

The XML data elements provide the bulk of the required disclosure in Form SH and are limited to the information requested in the instructions to the form. Data

[33] Additional information the manager wishes to report may be included on the Form SH provided that the information does not, either by its nature, quantity, or manner of presentation, impede the

elements 1 through 4 provide the date, identify the manager by CIK, and the name and CUSIP of the issuer. Data Elements 5 and 7 require the manager to report the number of securities that represent the manager's short position in the issuer as of the start and end of each calendar day during the reporting period. Data element 6 requires the manager to report the gross, not net, number of securities in the issuer that the manager sold short for each calendar day during the reporting period.

When determining the disclosure required in the XML tagged data file, an institutional investment manager may apply the exclusion in Rule 10a-3T(b)(2)(ii) on a day-by-day and data element-by-data element basis. For example, if a filer has triggered a filing obligation for a given calendar week, has start and end of day short positions on a particular day that do not qualify for the reporting exception, but does not effect any short sales on that day, the filer would disclose the appropriate numbers under elements 5 and 7 and enter zero under element 6. Using the same facts, if the filer did engage in short sales during that particular day but those sales in the aggregate met the reporting exception, the filer may enter "N/A" under element six. "N/A" can to be used any time a filer has a filing obligation and is omitting information under the reporting exception.

To the extent still relevant, institutional investment managers may look to the staff guidance provided pursuant to the Emergency Orders regarding reporting short sales and positions on Form SH such as the Guidance Regarding the Commission's Emergency Order Concerning Disclosure of Short Selling provided by the staff of the Divisions of Corporation Finance, Investment Management, and Trading and Markets available at http://www.sec.gov/divisions/marketreg/shortsaledisclosurefaq.htm.

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understanding or presentation of the required information. Only information requested by the Form SH and its instructions is permitted in the XML tagged data file.

Request for Comment

- Is the XML tagged data file format more easily generated than an ASCII document in columned or delimited format? Would XBRL tagged data be a preferred solution? Are there any other technology issues resulting from the use of XML tagged data format? Do filers have the ability to submit the XML tagged data by November 7, 2008?
- Should delimited ASCII text data be considered for transaction data? If the data is to be provided to the public, which data file format would be preferred? If the data is to be provided to the public, is there an advantage to using XML because a style sheet can be used to present XML data elements in a readable format?

IV. Other Matters

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.[34] This requirement does not apply, however, if the agency "for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest."[35] Further, the Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[36] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[37] The Commission, for good cause, finds that notice and solicitation of comment

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34 See 5 U.S.C. 553(b).

35 Id.

36 See 5 U.S.C. 553(d).

37 Id.

before Rule 10a-3T and Form SH is impracticable, unnecessary, or contrary to the public interest.

For the reasons we discussed throughout this release, we believe that we have good cause to act immediately to adopt this rule and form on a temporary interim final basis. As discussed throughout this release, we are concerned by recent sudden and excessive fluctuation of securities prices and disruptions in the fair and orderly functioning of the securities markets and believe that the nonpublic submission of Form SH may provide the Commission with useful information to combat market manipulation that threatens investors and our capital markets. Adopting the rules as interim temporary rules also will minimize any disruption in reporting by institutional investment managers of their short sale activities. Avoiding such disruption should obviate the need for those managers to stop and restart their reporting apparatus and should allow us uninterrupted access to the information in the reports during a time of significant market upheaval.

Rule 10a-3T takes effect on October 18, 2008. For the reasons discussed above, we have acted on a temporary interim final basis. We emphasize that we are requesting comments on the temporary rule and will carefully consider any comments that we receive. We intend to respond to the comments in a subsequent release. Moreover, this is a temporary rule that will expire on August 1, 2009. Setting a termination date for the rule will necessitate further Commission action no later than the end of that period if the Commission determines to continue the same, or similar, requirements contained in the temporary rule. The Commission finds that there is good cause to have Rule 10a-3T and Form SH effective as temporary interim rules on October 18, 2008 and that notice and public procedure in advance of effectiveness of the rules are impracticable, unnecessary and contrary to the public interest.[38]

V. PAPERWORK REDUCTION ACT

A. Background

Temporary Exchange Act Rule 10a-3 relates to a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 (PRA).[39] The title for the information collection is "Form SH" (OMB Control No. 3235-0646). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a current valid control number.

The Office of Management and Budget ("OMB") approved Form SH on September 19, 2008 in connection with the Commission's issuance of the Emergency Order to require institutional investment managers to file Form SH with the Commission.[40] We submitted revised burden estimates to OMB for review and approval in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13. Separately, we submitted the revised burden estimates to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. OMB has approved the revised Form SH burden estimates related to our adoption of Rule 10a-3T on an emergency basis.

B. Summary of Rule 10a-3T and Form SH Burden Estimates

Rule 10a-3T will require certain institutional investment managers that exercise investment discretion with respect to accounts holding section 13(f) securities that have an

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38 This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines.").

39 44 U.S.C. 3501 et seq.

40 Release No. 34-58591.

aggregate fair market value of at least $100,000,000 to file Form SH on a weekly basis during the period covered by this interim rule. The Form SH filing must be made on the last business day of each calendar week following a week in which the institutional investment manager has effected any short sale with respect to any section 13(f) security that is not an option. Form SH is filed on a nonpublic basis and compliance is mandatory.

With respect to each applicable section 13(f) security, the Form SH filing must reflect the number of securities sold short during the day, as well as the start of day short position and end of day short position, for that security on each calendar day of the prior week in which the institutional investment manager engaged in trading activity with respect to short sales. No Form SH filing is required when no short sales of a section 13(f) security have been effected during the reporting period to be covered by the Form SH filing or where all short sales and short positions are below the following thresholds on each day of the calendar week to be covered by the report:

- The short sales and short positions in the section 13(f) security constitute less than one-quarter of one-percent of that class of the issuer's section 13(f) securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any current report subsequent thereto, filed with the Commission pursuant to the Exchange Act, unless the manager knows or has reason to believe that the information contained therein is inaccurate; and
- The fair value market of the short sale and short position in the section 13(f) security is less than $10,000,000.

When we originally requested approval of Form SH in connection with the Emergency Orders, we estimated that the same number of respondents that file Form 13F also would file Form SH, and that each Form SH filing would impose an estimated five burden hours on each respondent. Some Form SH filers indicated that the five hour burden estimate is too low, so we are increasing it to 20 hours as explained below. We also now have actual data from the Form SH filings that we received on September 29, 2008, October 6, 2008 and October 14, 2008 upon which to base our revised burden estimates. We estimate that we will receive approximately 1,000 Form SH filings from institutional investment managers each week during the nine-month period during which Rule 10a-3T will be in effect.

Pursuant to Rule 10-3T, Form SH contains three fewer data elements than did the version of Form SH required by the Emergency Orders. Therefore, we estimate that 1,000 institutional investment managers will file 36 Form SH reports annually at an estimated 20 hours per filing for a total annual reporting burden of 720,000 hours.[41] The 20 hour per filing estimate is based on data received from a small sample of actual filers and a random sample of filings conducted by our Office of Economic Analysis. Staff in the Office of Economic Analysis sampled 100 of the Form SH filings that we received on October 6, 2008. The average number of pages filed was 8.2 and the median number of pages filed was 6, while the maximum number of pages included in a sample filing was 228 and the minimum was 1 page.

Based on limited data from a small sample of actual filers, we estimate that the legal costs of filing Form SH for investment managers that retain an outside law firm to be approximately $1000 per filing for 36 filings for a total of $36,000.[42] We further estimate the

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41 This estimate conservatively assumes that each Form SH filer will make a Form SH filing each week during the period covered by Rule 10a-3T.

42 The $1000 per filing estimate is based on two and a half hours of outside law firm time at a rate of $400 per hour.

filing agent costs to be $1500 per week for managers that retain an outside agent to assist them in filing Form SH on EDGAR for a total of $54,000 ($1,500 x 36), and a combined cost total of $90,000,000 ($90,000 per filer x 1000 filers).

We understand that many institutional investment managers incurred a much higher reporting burden than five hours per filing in connection with the Form SH reports that they filed to comply with the Emergency Orders. A substantial portion of the initial reporting burden, as discussed in more detail in the Cost-Benefit Analysis, was attributable to the compressed timeframe in which the managers had to comply with the newly created form and the need for new programs to combine data from two different types of automated information systems to satisfy the Form SH disclosure requirements. The revised 20 hour estimate and cost estimate reflects an estimated average reporting burden associated with Form SH for each of the 36 filings that some institutional investment managers must make during the nine month period covered by Rule 10a-3T.

C. Solicitation of Comments

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comments to: (1) evaluate whether Form SH is necessary for the proper performance of the functions of the agency, including whether it will have practical utility; (2) evaluate the accuracy of our estimate of the burden imposed by Form SH; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk

Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-31-08. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-31 -08, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549.

VI. Cost-Benefit Analysis

A. Background

As stated in the Emergency Orders, we are concerned about the potential for sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. In particular, we are concerned that some persons may manipulate the stock of issuers that have become temporarily weakened by current market conditions. Possible unnecessary or artificial downward price movements may be based on unfounded rumors and may be exacerbated by short selling. Such price declines can give rise to questions about the underlying financial condition of an issuer, which in turn can create a crisis of confidence that is not warranted by the issuer's true financial condition. This undue crisis of confidence can threaten an issuer's viability as a going concern, even when the underlying fundamentals of the firm do not suggest cause.

For example, financial institutions with demand deposit liabilities might experience unwarranted depositor withdrawals that, without replacement, could lead to a funding shortfall for the financial institution's long term assets, such as residential mortgages and commercial loans. Liquidation of these assets to meet depositor redemption could force sales at unfavorable prices that erode capital and increase the risk of insolvency and institutional failure.

Non-financial institutions can face similar risks from an undue crisis in confidence. Manufacturers that rely on credit with suppliers or financial institutions for production inputs might see this credit offered at less favorable terms, or even worse, become unavailable, placing undue burden on their working capital and cash reserves. An undue crisis in confidence also could lead customers to choose alternative products or producers if customers fear that future commitments, such as warrantees or service agreements, might not be honored.

We therefore believe that it is necessary to continue requiring institutional investment managers subject to the Form 13F filing requirements to report information concerning their short sales of Rule 13(f) securities on Form SH after the expiration of the Emergency Order dated October 2, 2008 on October 17, 2008. New Exchange Act Rule 10a-3T requires an institutional investment manager that exercises investment discretion with respect to accounts holding section 13(f) securities having an aggregate fair market value of at least $100 million to file Form SH with the Commission each calendar week immediately following a calendar week in which the manager effects a short sale of section 13(f) securities, other than options, exceeding stated thresholds. Rule 10a-3T and Form SH are temporary requirements that will expire on August 1, 2009.

B. Benefits

The securities markets have undergone significant stress in recent months. An expected benefit of Rule 10a-3T and Form SH is to help restore investor confidence in the markets. The disclosure may help to combat manipulative behavior by making it easier for us to analyze short selling activity. To the extent that the rule does reduce manipulative behavior while still permitting legitimate trading activity should help to alleviate any undue crisis of investor confidence and may strengthen the market's ability to correctly incorporate accurate information into securities prices.

Among other things, the Form SH disclosure will enable staff in our Office of Economic Analysis and Office of Compliance, Inspections and Examinations to analyze short selling patterns and use the data along with other information to study the impact of short selling on the market in times of financial crisis. For example, the Form SH disclosure can help Commission staff evaluate the effectiveness of some of our other emergency initiatives relating to short selling, such as our new temporary Rule 204T requiring short sellers and their broker-dealers to deliver securities by the settlement date (three days after the sale transaction date, or T+3).

In response to feedback on the Emergency Orders, we have further tailored the information collected. We believe that this will limit the expense of complying with the disclosure, while still providing us with the information that we need.

C. Costs

Rule 10a-3T will impose costs on institutional investment managers subject to the Form SH filing requirement. We estimate that approximately 1000 Form SH reports will be filed with the Commission each week during the period through August 1, 2009, and that each filing will impose an estimated reporting burden of 20 hours on the filer at an estimated internal cost of $3500 per filing,[43] plus an estimated $90,000 per filing in legal and filing costs for managers that retain the services of an outside law firm and EDGAR filing agent.[44]

In addition to the costs associated with the reporting burden, we understand that many institutional investment managers spent a substantial number of hours creating a reporting mechanism to capture the data required by Form SH when they first became subject to the reporting requirement under the Emergency Orders. The managers typically maintain an automated system to generate information about their short positions, and a different automated system to generate information about their trading activity. Due to the fact that Form SH requires information about the manager's short positions, as well as the number of securities sold short during the day, they had to create new programs to generate the necessary data.

The temporary rule will also be associated with implementation costs. By requiring filings in XML, filers will need to reprogram systems to be prepared to file in XML by November 7. In addition, changing the form to report fewer data items will also involved reprogramming costs. We believe that these extra costs are justified because the changes help to limit the costs and improve the ability of the Commission to use the information in the filings.

We recognize that the Form SH reporting requirement imposed by Rule 10a-3T may result in increased short selling costs for participants that may impact legitimate

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43 Consistent with recent rulemaking estimates, we used a $175 per hour rate to estimate the cost of work performed internally at the company.

44 We do not expect that all Form SH filers will retain the services of an outside law firm or filing agent to assist them, but we conservatively assume that they will for purposes of these cost estimates.

short selling activities. We sought to limit the potential costs associated with Form SH filing under Rule 10a-3T by:

- Imposing the Form SH filing obligation only on institutional investment managers that exercise discretion over accounts holding section 13(f) securities having an aggregate fair market value of at least $100 million – these managers have experience with SEC filing and tend to be larger and better able to bear the cost;
- Requiring reporting only about section 13(f) securities, but not including options or equity securities of all public companies—the section 13(f) category of securities is a well-defined, pre-existing category of securities that institutional investment managers use in connection with their Form 13F filing obligations;
- Not requiring Form SH to be filed following a week in which the institutional investment manager did not effect any short sale of a section 13(f) security, even if the manager closes a short position during that week;
- Allowing aggregation of reporting on Form SH across multiple institutional investment managers;
- Establishing thresholds below which short sales need not be reported on Form SH; and
- Establishing a last business day of each calendar week reporting deadline, which should help to reduce weekend labor and systems time

We request comments on this Cost-Benefit Analysis and any of the costs and benefits associated with Rule 10a-3T and Form SH. We solicit quantitative data to assist with our assessment of the costs and benefits of the rule and form.

- Have we accurately estimated the costs?
- Are additional costs involved in complying with the rule? What are the types, and amounts, of the costs?
- Can the rule be modified to mitigate costs?
- Do the benefits justify the costs?
- Will the Form SH reporting requirements influence the day-to-day decisions made by institutional investment managers in any substantive way? For example, will managers choose in some cases to avoid short selling, or to short through alternative vehicles such as OTC derivatives to avoid reporting?
- Given that Rule 10a-3T requires reporting of short sales and short positions, but does not require Form SH filers to report whether the short sales are being used to hedge other positions, does the Form SH information provide an accurate picture of the short selling activities of institutional investment managers and their clients? Is there an alternative reporting requirement that would more accurately reflect managers' true activities?
- Rule 10a-3T requires a single form that aggregates short positions across multiple systems and across portfolios managed for multiple customers. Does the aggregation process pose any special difficulties or impose additional costs beyond those that would be incurred if filers could submit separate reports for separate units or systems?

- How costly will it be for Form SH filers to develop the code needed to file Form SH in XML format? Are there less costly alternatives that will present the Form SH data in a machine readable format?

VII. Consideration of Burden of Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act[45] 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[46] and Section 2(c) of the Investment Company Act of 1940[47] require us, when engaging in rulemaking 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.

We believe that Rule 10-a3T will not have an adverse impact on competition among the institutional investment managers required to file Form SH and other parties effecting short sales because the Commission will keep Form SH information nonpublic to the extent permitted by law. We have received comments indicating that the information required by Form SH is highly proprietary and could be used to try and reverse engineer an institutional investment manager's trading strategy.[48] In addition, there is a concern that public disclosure could inaccurately suggest that the managers

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45 15 U.S.C. 78w(a)(2).

46 15 U.S.C. 78c(f).

47 15 U.S.C. 80a-2(c).

48 See, for example, letter from WilmerHale dated October 10, 2008 available in file No. S7-24-08.

effecting short sales have a negative view of some issuers' prospects given that short sales may be a part of some managers' routine hedging strategies.[49]

Further, the rule imposes similar costs on institutional investment managers of similar size, given that only larger institutional investment managers subject to the Form 13F filing requirement are subject to the Form SH filing requirement. Therefore, it does not create any competitive disadvantages among these managers. Rule 10a-3T could, however, create an advantage for smaller institutional investment managers that are not subject to the Form SH filing requirement as compared to the larger filers. We believe any burden on competition imposed by the rule is necessary or appropriate in furtherance of the purposes of the Exchange Act because the rule will assist us in addressing concerns that short selling may be used to manipulate the stock of issuers.

To the extent Rule 10a-3T achieves its objective of combating market manipulation, the rule should promote efficiency and capital formation by increasing investor confidence and strengthening the market's ability to correctly incorporate accurate information into securities prices. We request comment on these matters in connection with the rule.

VIII. Regulatory Flexibility Certification

Section 3(a) of the Regulatory Flexibility Act requires the Commission to undertake a Regulatory Flexibility Analysis of the effect of its rules on small entities unless the Commission certifies that the rules do not have a significant economic impact on a substantial number of small entities.[50] Pursuant to Section 605(b) of the Regulatory

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49 Id.

50 5 U.S.C. 603(a).

Flexibility Act, the Commission hereby certifies that Exchange Act Rule 10a-3T and Form SH do not have a significant impact on a substantial number of small entities.[51] A "small entity" is defined under Rule 0-7 of the Investment Advisers Act of 1940 for purposes of the Regulatory Flexibility Act as an investment adviser that:

- has assets under management and reported in its annual updating amendment to Form ADV of less than $25 million;
- did not have total assets of $5 million or more on the last day of its most recent fiscal year; and
- does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year.

Rule 10a-3T requires only an institutional investment manager that exercises investment discretion over investment accounts holding section 13(f) securities having an aggregate fair market value of at least $100 million on the last trading day of a month that is relevant to the period covered by the rule to file Form SH with the Commission. Therefore, we do not expect the rule to affect a significant number of small entities under the definition of "small entity" set forth above. Not all of the institutional investment managers that may be required to file Form SH are registered as investment advisers under the Investment Advisers Act. Despite the fact that the Rule 0-7 definition of a

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51 Although the requirements of the Regulatory Flexibility Act do not apply to rules adopted under the Administrative Procedure Act's "good cause" exception, see 5 U.S.C. 601(2) (defining "rule" and notice requirements under the Administrative Procedure Act), we have nevertheless provided this certification.

small entity is designed for purposes of the Investment Advisers Act, it also provides a useful basis for determining whether unregistered investment advisers are small entities.

We solicit comment on the certification. Commenters are asked to describe the nature of any impact on small entities and provide any empirical data.

IX. Statutory Basis and Text of Amendments

We are adopting amendments to rules pursuant to Sections 3(b), 10 and 23(a) of the Exchange Act, as amended.

List of Subjects

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II of the Code of Federal Regulations as follows:

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

1. The 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. Section 240.10a-3T is added to read as follows:

§ 240.10a-3T Temporary Rule for reporting short sales by institutional investment managers

(a)(1) For purposes of this section, the terms "investment discretion" and "section 13(f) securities" shall have the meanings set forth in § 240.13f-1(b) and § 240.13f-1(c), respectively.

(2) For purposes of this section, the term "short sale" shall have the meaning set forth in § 242.200(a) of this chapter, and, for purposes of Form SH a "short position" is the aggregate gross short sales of an issuer's section 13(f) securities (excluding options), less purchases to close out a short sale in the same issuer. The Form SH short position is not net of long position in the issuer. If a person that has loaned a security to another person sells the security and a bona fide recall is initiated within two business days after trade date, the person that has loaned the security is deemed to own the security for purposes of Rule 200(g)(1) and Rule 200(b) of Regulation SHO, and such sale will not be treated as a short sale.

(b)(1) Every institutional investment manager that exercises investment discretion with respect to accounts holding section 13(f) securities that has filed, or was required to file, a Form 13F (§ 249.325 of this chapter) for the calendar quarter, as required under Section 13(f) of the Act (15 U.S.C. 78m(f)) and § 240.13f-1(a) thereunder, shall file a report on Form SH (§ 249.326T of this chapter) with the Commission on the last business day of each calendar week immediately following a calendar week in which the institutional investment manager has effected a reportable short sale with respect to a section 13(f) security that is not an option.

(2) An institutional investment manager is not required to file Form SH to report short sales or short positions of section 13(f) securities on Form SH where:

(i) No short sales of a section 13(f) security have been effected during the reporting period to be covered by the Form SH filing; or

(ii) On each calendar day during the calendar week, the start of day short position, the gross number of securities sold short during the day and the end of day short position each constitute less than one-quarter of one percent of that class of the issuer's section 13(f) securities issued and outstanding as reported on the issuer's most recent annual, quarterly or current report filed with the Commission pursuant to section 13 of the Exchange Act, unless the manager knows or has reason to believe the information contained therein is inaccurate, and the fair market value of the start of day short position, the gross number of securities sold short during the day and the end of day short position each are less than $10,000,000.

(3) Once a determination is made that a Form SH filing is required, an institutional investment manager is not required to report short sales or short positions of section 13(f) securities on Form SH where:

(i) On any calendar day of the calendar week, the start of day short position, the gross number of securities sold short during the day, or the end of day short position in the section 13(f) security constitutes less than one-quarter of one percent of that class of the issuer's section 13(f) securities issued and outstanding as reported on the issuer's most recent annual, quarterly or current report filed with the Commission pursuant to section 13 of the Exchange Act, unless the manager knows or has reason to believe the information contained therein is inaccurate, and the fair market value of the start of day short position, the gross number of securities sold short during the day, or the end of day short position is less than $10,000,000. The institutional investment manager must designate in the appropriate data element its reliance on this exception with respect to information otherwise required to be reported; or

(ii) A broker-dealer seeks to execute a customer order, either in whole or in part, through a riskless principal transaction, and a short sale results from a sale order of a customer who is net long the section 13(f) security, or a purchase order of a section 13(f) security.

(4) The Form SH shall be nonpublic to the extent permitted by law.

(c) A report on Form SH shall identify the date of the transaction, the institutional investment manager by EDGAR Central Index Key, the issuer name and CUSIP for the relevant securities and reflect the start of day short position, the gross number of securities sold short during the day, and the end of day short position, on each day of the calendar week in which short sale trading activity occurred.

(d) This section will expire on August 1, 2009.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 continues to read in part as follows: Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

4. Add § 249.326T and Temporary Form SH to read as follows:

§ 249.326T Form SH, weekly report of short sales and positions

(a) This form shall be used by institutional investment managers to file weekly reports pursuant to § 240.10a-3T of this chapter. A weekly report on this form pursuant to § 240.10a-3T of this chapter shall be filed on the last business day of each calendar week immediately following a calendar week in which the institutional investment manager effected a short sale and shall be nonpublic to the extent permitted by law.

(b) The temporary section will expire on August 1, 2009.

Note: The text of Form SH does not, and this amendment will not, appear in the Code of Federal Regulations.

OMB APPROVAL
OMB Number: 3235-0646
Expires: April 30, 2009
Estimated average burden hours per response: 20.0

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM SH

WEEKLY REPORT OF SHORT SALES AND SHORT POSITIONS

GENERAL INSTRUCTIONS

1. Rule as to Use of Temporary Form SH ("Form SH"). Institutional investment managers ("Managers") that exercise investment discretion with respect to accounts holding section 13(f) securities, as defined in rule 13f-1(c) under the Securities Exchange Act of 1934 [15 U.S.C. 78m(f)] ("Exchange Act"), who have filed or were required to file a Form 13F for the previous calendar quarter, must file a nonpublic report on Form SH with the Commission to report certain information about short sales and short positions. The nonpublic Form SH filing must be made on the last business day of each calendar week immediately following a Form SH reporting period (i.e., the preceding Sunday-Saturday calendar week) in which the Manager entered into any new short positions with respect to any section 13(f) securities except for any short positions for options ("SH Short Positions"). The nonpublic Form SH will report SH Short

Positions for the Sunday-Saturday calendar week that precedes the date on which the Form SH is due to be filed.

2. Rules to Prevent Duplicative Reporting. If two or more Managers that are required to file a report on Form SH for the reporting period exercise investment discretion with respect to the same securities, only one such Manager must include information in its reports on Form SH. A Manager whose information is reported on Form SH by another Manager (or Managers), must identify the Manager(s) reporting on its behalf.

3. Filing of Form SH. A Form SH report that is filed by a Manager with the Commission shall be nonpublic to the extent permitted by law. A Manager must label its Form SH as non-public by adding the phrase NONPUBLIC (in bold and capital letters) at the top and bottom of each page of the form with the exception of the XML tagged data file containing transaction data. A Manager must file a Form SH report with the Commission on the last business day of each calendar week immediately following the preceding calendar week period (Sunday – Saturday) in which the Manager has entered into any new SH Short Position(s) in accordance with Rule 232.13 of Regulation S-T [17 CFR 232.13]. The Form SH must be filed electronically using the Commission's EDGAR system.

4. Official List of Section 13(f) Securities. The Official List of Section 13(f) Securities published by the Commission (the "13F List") lists the securities the holdings of which a Manager is to report on Form 13F. See rule 13f-1(c) [17 CFR 240.13f-1(c)]. Form SH filers may rely on the current 13F List in determining whether they need to report on Form SH information about any particular equity security, excluding short

positions for options that are on the 13F List. The 13F List is available on the SEC's Web site, at http://www.sec.gov/divisions/investment/13flists.htm. Paper copies are available at a reasonable fee from the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549-1520.

Paperwork Reduction Act Information

The Office of Management and Budget has approved this collection of information pursuant to 44 U.S.C. § 3507 and 5 C.F.R. § 1320.13. The OMB control number for this collection of information is 3235-0646. 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 control number. We estimate that providing the requested information will take, on average, approximately 20 hours. Any member of the public may direct to the Commission any comments concerning the accuracy of this burden estimate and any suggestions for reducing this burden.

Filings with the form types set forth in this instruction will be filed on a nonpublic basis.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

TEMPORARY FORM SH

WEEKLY REPORT OF SHORT SALES AND SHORT POSITIONS

Report for the Period Ended: ____[Month, Day, Year]_____

Check here if Amendment [ ]; Amendment Number: _____

This Amendment (Check only one): [ ] is a restatement.

[ ] adds new entries.

Institutional Investment Manager Filing this Report:

Name: ______________________________

Address: ______________________________

____

____

Form 13F File Number: 28-____________

Central Index Key (CIK) Number: __________

The institutional investment manager filing this report and the person by whom it is signed hereby represent that the person signing the report is authorized to submit it, that all information contained herein is true, correct and complete, and that it is understood that all required items, statements, schedules, lists, and tables, are considered integral parts of this form.

Person Signing this Report on Behalf of Reporting Manager:

Name: ______________________

Title: ____________________________

Phone: ____________________________

Signature, Place, and Date of Signing

________________________________ ____________________ ____________

[Signature] [City, State] [Date]

Report Type (Check only one):

[ ] FORM SH ENTRIES REPORT. (Check here if all entries of this reporting manager are reported in this report.)

[ ] FORM SH NOTICE. (Check here if no entries reported are in this report, and all entries are reported by other reporting manager(s).)

[ ] FORM SH COMBINATION REPORT. (Check here if a portion of the entries for this reporting manager is reported in this report and a portion is reported by other reporting manager(s).)

List of Other Managers Reporting for this Manager:

Provide a list of the name(s), Form 13F file number(s) and CIK numbers of all institutional investment managers who are reporting for this manager.

[If there are no entries in this list, state "NONE".]

Number of Other Included Managers: ____________________

Total Number of Transactions Reported: ___________________

List of Other Included Managers:

Provide a numbered list of the name(s), Form 13F file number(s) and CIK numbers of all institutional investment managers with respect to which this Form SH report is filed, other than the manager filing this report.

[If there are no entries in this list, state "NONE".]

INFORMATION TABLE

Element 1	Element 2	Element 3	Element 4	Element 5	Element 6	Element 7
Date	CIK of Manager	Name of Issuer	CUSIP	Short Position (Start of Day)	Number of Securities Sold Short (Day)	Short Position (End of Day)

* * * * *

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 15, 2008

Commissioner Casey and Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58787 / October 15, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13273

In the Matter of **STEWART KALTER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Stewart Kalter ("Respondent" or "Kalter").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

1. These proceedings arise out of the involvement of an unregistered and unlicensed person in a registered broker-dealer's transactions in securities and the broker-dealer's filing of inaccurate reports with the Commission.

Respondent

2. Kalter was the president and chief compliance officer of Vision Securities, Inc., ("Vision"), a registered broker-dealer, from November 2003 through December 2006. At all relevant times, he was a registered representative and registered principal of Vision. Kalter, who has been in the securities industry since at least November 1995, is 36 years old and a resident of Melville, New York.

Other Relevant Entity

3. Vision is a registered broker-dealer with its principal place of business in Melville, New York. It first registered with the Commission in 1993. In March 2007, the NASD[2] fined Vision $27,500 for failure to maintain the required net capital, among other violations. On February 29, 2008, as a result of the firm's failure to maintain the required net capital, the NASD placed the firm under a cease-and-desist order pursuant to which the firm can only take unsolicited orders.

The Inaccurate Filings

4. From at least July 2005 through July 2006, Vision Securities was controlled by an individual (the "controlling representative") who was associated with it as a registered representative and corporate secretary and was a part owner of GCG Holdings, Inc., the entity that owned the firm. Although Kalter was nominally the president of Vision during that period, he acted solely at the direction of the controlling representative in all important matters, including hiring, setting compensation, and determining which bills Vision would pay.

5. During that time, Vision's Form BD did not identify the controlling representative as a control person. On about April 27, 2006, June 8, 2006 and July 3, 2006, Vision amended the Form BD, and failed to disclose that the controlling representative was a control person of the firm.

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

2 In July 2007, the NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange were consolidated into a new entity, the Financial Industry Regulatory Authority, commonly referred to as FINRA. All of the conduct discussed herein occurred before the creation of FINRA.

Kalter signed these April, June and July 2006 Form BD amendments, even though he knew that the controlling representative was a control person of Vision.

<u>Unlawful Involvement of Unregistered and Unlicensed Person in Securities Transactions</u>

6. From about October 2005 until about May 2006, Vision Securities solicited investors in connection with a private placement of securities by Issuer X, in exchange for commissions based on the amount Vision raised. A number of the investors who participated in the offering and purchased securities of Issuer X through Vision were solicited by an individual who was not registered as a broker-dealer or approved by a national securities exchange or national securities association to be involved in effecting in securities transactions. This individual was the president of a company that published an on-line, subscription-based newsletter featuring market analysis and stock recommendations (the "newsletter publisher").

7. From about October 2005 until about May 2006, Kalter arranged for Vision to pay the newsletter publisher in excess of $200,000, based on the amount invested in the Issuer X private placement by investors solicited by the newsletter publisher's president. When he did so, Kalter knew that neither the publisher nor the president were registered as a broker-dealer and that the newsletter publisher's president was not approved by a national securities exchange or national securities association to be involved in effecting securities transactions.

<u>Violations</u>

8. Section 17(a) of the Exchange Act requires registered brokers or dealers, among other things, "to make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Exchange Act]." Section 15(b)(1) of the Exchange Act requires all brokers or dealers applying for registration with the Commission to file a Form BD with the Commission. Among other things, Form BD requires registered brokers and dealers to disclose any person who "controls" the broker or dealer. Form BD defines "control" as "[t]he power, directly or indirectly, to direct the management or policies of a company . . . ." A person is presumed to control a broker when he is "a director, general partner, or officer exercising executive responsibility (or having similar status or functions)." Rule 15b3-1, promulgated pursuant to Exchange Act Sections 15(b), 17(a), and 23(a), requires that a broker-dealer promptly file any amendment on Form BD if any information in the broker-dealer's Form BD is or becomes inaccurate for any reason. The courts and the Commission have long recognized the importance of disclosing the identity of those who control a broker or dealer. "[T]he correct disclosure of the . . . controlling persons of an applicant is more than a 'minor' point, indeed it is most important to the proper administration of the [Exchange] Act." <u>Capital Funds, Inc. v. SEC</u>, 348 F.2d 582, 588 (8th Cir. 1968). <u>See also</u> <u>Financial Counselors, Inc. v. SEC</u>, 339 F.2d 196, 197 (2d Cir. 1964) (upholding Commission's revocation of broker-dealer's registration when true control person was not disclosed on the registration application or any amendments thereto); <u>SEC v. Moran</u>, 922 F. Supp. 867, 901 (S.D.N.Y. 1996) (noting that supplying complete and accurate information in Form BD "furthers the interest of public disclosure, informed decision making, and allows the SEC to monitor securities transactions in order to fulfill the legislative mandate behind the establishment

of the securities acts."). As a result of the conduct described in paragraphs 4 and 5 above, Kalter willfully aided and abetted and caused Vision's violations of Section 17(a) of the Exchange Act and Rule 15b3-1 thereunder.

9. As a result of the conduct described in paragraphs 6 and 7 above, Kalter willfully aided and abetted and caused Vision's violations of Sections 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder. Rule 15b7-1 provides that "[n]o registered broker or dealer shall effect any transaction in, or induce the purchase or sale of, any security unless any natural person associated with such broker or dealer who effects or is involved in effecting such transaction is registered or approved in accordance with the standards of training, experience, competence, and other qualification standards (including but not limited to submitting and maintaining all required forms, . . . and passing any required examinations) established by the rules of any national securities exchange or national securities association of which such broker or dealer is a member . . . ."

Undertaking

Respondent shall provide to the Commission, within ten days after the end of the three month suspension period described in Section IV below, an affidavit that he has complied fully with the suspension.

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 Respondent Kalter's Offer.

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

A. Respondent shall cease and desist from causing any violations and any future violations of Sections 15(b)(7) and 17(a) of the Exchange Act and Rules 15b3-1 and 15b7-1 thereunder.

B. Respondent be, and hereby is, suspended from association with any broker or dealer for a period of three months, effective on the second Monday following the entry of this Order.

C. IT IS FURTHER ORDERED that Respondent shall pay a civil penalty of $10,000 to the United States Treasury. Payment shall be made in the following installments: (1) $5,000 within ten days of the entry of the Order; (2) $2,500 within 180 days of the entry of the Order; and (3) $2,500 within 360 days of the entry of the Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. 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 cover letter that identifies Stewart Kalter 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 Leslie Kazon, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York 10281.

By the Commission.

Florence E. Harmon
Acting 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
Rel. No. 58789 / October 15, 2008

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2799 / October 15, 2008

Admin. Proc. File No. 3-8394

In the Matter of VICTOR TEICHER c/o Andrew J. Levander David S. Hoffner Dechert, LLP 1095 Avenue of the Americas New York, NY 10036	ORDER DENYING MOTION TO MODIFY BAR ORDER

I.

Victor Teicher moves to modify a 1998 order barring him from association with any broker, dealer, investment adviser, investment company or municipal securities dealer (the "1998 Order"). 1/ Teicher requests that the 1998 Order be modified to permit him to associate with Cedarview Capital Management, LP ("Cedarview"), a registered investment adviser "in which he has no economic interest," as a portfolio manager. Specifically, Teicher asks that he be permitted to "provide portfolio management services to Cedarview in connection with the establishment of a $30 million investment fund" (the "Proposed Fund"). Teicher represents that the "start-up capital" for the Proposed Fund will be provided by Teicher and "certain highly sophisticated investors with whom" Teicher has a relationship, although Teicher also hopes to attract additional third-party investors. Teicher further represents that trading in the Proposed Fund would be "supervised" by Cedarview's three principals, none of whom has any disciplinary record, and that each trade would receive the prior approval of one of the Firm's principals. The Division of Enforcement (the "Division") opposes Teicher's motion as not being consistent with

1/ Victor Teicher, 53 S.E.C. 581 (1998), aff'd in part, rev'd in part, 177 F.3d 1016 (D.C. Cir. 1999) (affirming Commission order barring Teicher but reversing bar order as to separate respondent).

the public interest or investor protection. We agree with the Division and, therefore, have determined to deny the motion.

II.

A. The 1998 Order was imposed following Teicher's conviction for insider trading in 1990. On April 6, 1990, a jury convicted Teicher and Victor Teicher & Co., L.P., a former unregistered investment adviser that Teicher controlled, of criminal securities fraud charges for trading on the basis of material non-public information that Teicher knew had been misappropriated. 2/ Teicher was sentenced to eighteen months' imprisonment, placed on five years' probation and fined $200,000. Teicher & Co. was fined $600,000. On December 11, 1997, in a separate civil proceeding brought by the Commission, Teicher was enjoined by consent from violations of antifraud provisions, Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5 and 14e-3, and was ordered to pay disgorgement and penalties, based on the same underlying misconduct. 3/ On the basis of the criminal conviction, we instituted administrative proceedings against Teicher. Following litigated proceedings, we issued the 1998 Order.

B. On November 5, 2007, we denied a motion by Teicher to modify the 1998 Order (the "2007 Order"). 4/ At that time, Teicher requested permission to associate with a then-unregistered investment adviser which would manage the assets of Teicher family members and a limited number of "extremely sophisticated" investors, with knowledge of Teicher's disciplinary history. To address compliance concerns, Teicher represented, among other things, that the investment adviser would register with the Commission, designate a compliance officer and retain an independent consultant to monitor all trading and investment activity.

In rejecting Teicher's motion, we observed that "[t]he underlying misconduct, participation in an extensive insider trading scheme, involved serious violations of the antifraud provisions of the federal securities laws," and that "[n]ine years have elapsed since the imposition

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2/ United States v. Teicher, No. 88 Cr. 796 (CSH) (S.D.N.Y.), aff'd, 987 F.2d 112 (2d Cir. 1993). Teicher and Victor Teicher & Co., L.P. were convicted on nine counts of securities fraud in violation of Exchange Act §§10(b), 15 U.S.C. §§ 78j(b), Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5, and 18 U.S.C. § 2; two counts of fraud in connection with a tender offer in violation of Exchange Act § 14(e), 15 U.S.C. §§ 78n(e) and Exchange Act Rule 14e-3, 17 C.F.R. § 240.14e-3, and one count of conspiracy to violate the securities laws and anti-fraud laws, in violation of 18 U.S.C. § 371. Teicher was also convicted on two counts of mail fraud in violation of 18 U.S.C. §§ 1341 and 1342.

3/ SEC v. Victor Teicher, No. 91 Civ. 1634 (MP) (S.D.N.Y. Dec. 11, 1997).

4/ Victor Teicher, Securities Exchange Act Rel. No. 56744 (Nov. 5, 2007), 91 SEC Docket 3068.

of the bar, a time frame that is not unduly lengthy." 5/ We noted that Teicher had not sought permission to associate with any entity regulated by the Commission since imposition of the bar and, therefore, there was "no history of compliance in an associated capacity that would support modification of the bar order." 6/ We also expressed our concern that Teicher was proposing "to re-enter the securities industry as the head [and owner] of a firm," and that this would create a "difficult supervisory situation" for the persons proposed to be hired as independent consultant and compliance officer for the firm. We concluded that the public interest and investor protection would not be served if Teicher were permitted to associate with an investment adviser, as he had proposed.

III.

We consider requests to modify bar orders by determining whether, "under all the facts and circumstances presented, it is consistent with the public interest and investor protection to permit the petitioner to function in the industry without the safeguards provided by the bar." 7/ We have stated that administrative bars should "remain in place in the usual case and be removed only in compelling circumstances." 8/ Further, we have made clear that, when an unqualified bar has been imposed, as is the case here, this "evidences [our] conclusion that the public interest is served by permanently excluding the barred person from the securities industry . . . [and that], absent extraordinary circumstances, a person subject to an unqualified bar will be unable to establish that it is in the public interest to permit reentry to the securities industry." 9/ This exercise of caution before modifying or lifting administrative bars "ensures that the Commission,

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5/ Id. at 3070.

6/ Id. at 3071. In the 2007 Order, we noted that Teicher had not made an application pursuant to Commission Rule of Practice 193, 17 C.F.R. § 201.193, which governs applications by barred individuals for consent to associate with, among other things, investment advisers. Id. at 3070. We further stated that, in any event, Teicher's submission did not meet the requirements of Rule 193. Id. at 3070 n.7. Teicher's current motion also does not appear to meet the requirements of Rule 193.

7/ William Masucci, Exchange Act Rel. No. 53121 (Jan. 13, 2005), 87 SEC Docket 347, 348; Peter F. Comas, Exchange Act Rel. No. 49894 (June 18, 2004), 83 S.E.C. Docket 251, 252; Edward I. Frankel, 57 S.E.C. 186, 193 (2003); Ciro Cozzolino, 57 S.E.C. 175, 181 (2003); Stephen S. Wien, 57 S.E.C. 162, 170 (2003).

8/ Charles E. Gaecke, Investment Advisers Act Rel. No. 2681 (Dec. 4, 2007) 92 SEC Docket 321, 322.

9/ Unqualified Bar Orders, Exchange Act Rel. No. 34720 (Sept. 13, 1994), 57 SEC Docket 1941, 1941 (emphasis in original).

in furtherance of the public interest and investor protection, retains its continuing control over such barred individuals' activities." 10/

Consideration of a range of factors guides the public interest and investor protection inquiry. These factors include:

> the nature of the misconduct at issue in the underlying matter; the time that has passed since issuance of the administrative bar; the compliance record of the petitioner since issuance of the administrative bar; the age and securities industry experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar; whether the petitioner has identified verifiable, unanticipated consequences of the bar; the position and persuasiveness of the Division of Enforcement's response to the petition for relief; and whether there exists any other circumstances that would cause the requested relief from the administrative bar to be inconsistent with the public interest or the protection of investors. 11/

We did not find, in 2007, that a consideration of those factors justified a modification of the 1998 Order, and nothing contained in Teicher's current motion, submitted less than a year after the 2007 Order, causes us to alter that conclusion.

Teicher contends that the proposed association with Cedarview satisfies our concern, expressed in the 2007 Order, that Teicher should not re-enter the securities industry as the head of a firm. He asserts that, "[i]n light of the supervisory and compliance procedures" proposed in his motion, "the elapse of more than twenty years since the events giving rise to the Bar and Teicher's unblemished history during such lengthy period," the bar should be modified to permit him to associate with Cedarview.

The Division argues that there is no basis for reassessing our earlier decisions to bar Teicher and to deny his 2007 motion to modify the bar. It argues that, "[t]o the extent that there is a distinction between this motion and that filed in 2007, it is limited to the differences between the proposed employers and the related terms and conditions of Teicher's association." The Division asserts that, while Teicher has sought to correct one of the Commission's concerns by proposing to associate with Cedarview, "the critical point here is that nothing in Teicher's situation presents -- or even suggests -- the 'compelling circumstances' that would distinguish him from anyone else subject to a bar order . . . ."

10/ Gaecke, 92 SEC Docket at 322-23.

11/ Gaecke, 92 SEC Docket at 323. We also have observed that no single factor is dispositive. See, e.g., Frankel, 57 S.E.C. at 193.

We agree that there are no compelling circumstances to justify Teicher's return to the securities industry. While we appreciate that Teicher has taken certain steps to address some of the concerns raised in the 2007 Order, we nevertheless remain troubled about the possibility of further misconduct in the event he is permitted to return to the industry. For example, although technically not a principal of Cedarview, given the large amount of capital that likely will be contributed by Teicher and the other investors with whom Teicher has an existing relationship, we are concerned that this could give Teicher significant influence over the firm's operations. In short, effective supervision by Cedarview's senior management could be hampered given his and his associates' financial importance to the firm. In light of the serious nature of the underlying misconduct, the fact that only ten years have elapsed since the imposition of the bar, and our concerns regarding the terms of Teicher's proposed association with Cedarview, we believe that it would be inconsistent with the public interest and investor protection to modify the bar in the manner proposed by Teicher.

Accordingly, IT IS ORDERED that the motion of Victor Teicher to modify the administrative bar order be, and it hereby is, denied.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2802 / October 16, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13276

In the Matter of MEDCAP MANAGEMENT & RESEARCH LLC and CHARLES FREDERICK TONEY, JR. Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND CEASE-AND-DESIST ORDERS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against MedCap Management & Research LLC ("MMR") and Charles Frederick Toney, Jr. ("Toney") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders ("Order"), as set forth below.

III.

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

Summary

Respondent Toney, through his investment advisory firm MedCap Management & Research LLC ("MMR"), is the manager of MedCap Partners L.P. ("MedCap"), a hedge fund which suffered dramatic losses throughout 2006. At the end of the fund's third quarter, in an effort to report favorable news to the fund's investors, Toney – through a separate fund he managed – placed large orders for a thinly-traded OTC Bulletin Board stock ("OTC Company") in which MedCap was heavily invested. Toney's extensive purchases succeeded in driving the price of the stock up 338% on the last four days of the quarter. Because the stock (a small health care company) represented over a third of MedCap's holdings, the brief boost in its price inflated the reported value of the MedCap fund from approximately $9 million to $38 million.

By engaging in "portfolio pumping" – pushing up the price of a thinly-traded holding to boost fund asset values at the end of a reporting period – Toney was able to mask over 40% of MedCap's loss for the quarter. Indeed, immediately after the quarter ended, Toney reported to MedCap's investors that the fund's investments had begun to "bounce" and the fund's performance was improving. Toney breached his fiduciary duties to both MedCap (which paid higher management fees due to the inflated quarter-end asset value) and his other fund (which paid high prices to acquire OTC Company stock and drive up the share price).

Accordingly, MMR willfully violated the antifraud provisions of the Advisers Act, and Toney willfully aided and abetted and caused those violations.

Respondents

1. Respondent MMR, a Delaware limited liability company, is an investment adviser located in San Francisco, California. The firm is registered as an investment adviser with the California Department of Corporations. MMR is the investment adviser of two hedge funds, MedCap and MedCap Partners Offshore, Ltd. ("Offshore"). As investment adviser, MMR possesses sole and complete authority to manage the funds' activities.

2. Respondent Toney, age 42, lives in San Francisco, California, and is Managing Member of MMR. Toney handles all trading and investment decisions at MMR. Since December 2003, Toney has also served on OTC Company's Board of Directors.

Other Relevant Entities

3. MedCap Partners L.P., a Delaware Limited Partnership, is one of two hedge funds managed by MMR. Beginning in early 2006, MedCap experienced sharp declines in assets. On December 31, 2005, MedCap had approximate assets of $125 million; redemptions and significant market decline caused that number to drop to $15 million by the end of 2006. MedCap's assets declined to $5 million by the end of 2007.

4. MedCap Partners Offshore, Ltd., a Cayman Islands Exempted Limited Partnership, is the smaller of two hedge funds managed by MMR.

Background

5. Since November 2001, Toney has served as the Managing Member and sole owner of MMR, handling all trading and investment decisions at MMR. MMR charged MedCap a quarterly management fee of 0.25% of each non-affiliated partner's capital account, as well as a 20% annual performance incentive fee on any gains. MMR calculated its management fee using the fund's balance as of the first day of each quarter.

6. In addition to his fund responsibilities, Toney served on the Board of Directors of OTC Company, a company whose stock Toney had accumulated for years for MedCap through private offerings. As of September 25, 2006, MedCap owned approximately 10.3 million shares of OTC Company in the form of common stock, options, preferred stock, and convertible warrants. Based on OTC Company's September 25 closing price of $0.85 per share, MedCap's OTC Company holdings had an estimated value of $8.8 million, or over 30% of MedCap's total asset value.

January to Mid-September 2006: MedCap Loses 75% of Its Value and Redemptions Increase

7. In 2006, MedCap experienced significant investment losses. The fund's value dropped 3.7% in the first quarter (ended March 31), under-performing all ten of the fund's benchmarks, which included both healthcare-specific and broader market indices. For the second quarter (ended June 30), MedCap lost an additional 36.4%, trailing its benchmarks by an average of over 30 points. MedCap's second quarter results were due in part to a freefall in OTC Company's share price, which posted a 75% decline during that period. By September 25, MedCap had fallen an estimated 62% from its second quarter value. In real terms, this was a quarterly loss of nearly $50 million, from MedCap's June 30 value of approximately $76 million to an estimated September 25 value of $29 million.

8. The number of investors leaving MedCap also rose during this time. On June 30, seven partners redeemed their full capital interests in the fund, accounting for over 6% of MedCap's total assets. By August 31, after MedCap's second quarter results, 10 more partners submitted demands for full redemption.[1] Given MedCap's approximate value of $29 million on September 25, these 10 partners made up nearly 15% of the fund. With only $250,000 in approximate cash on hand, MedCap distributed securities instead of cash to MedCap's departing investors, a first for the fund.

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[1] MedCap generally allowed partners to redeem part or all of their MedCap stakes only at the end of a quarter and only after giving 30 days notice. Thus, August 31 was the deadline for a third quarter redemption.

September 26-29, 2006: Toney Uses The Offshore Fund To Inflate OTC Company's Price and Increase MedCap's Value

9. Faced with another down quarter and mounting redemptions, Toney used the final four trading days of September to elevate the price and trading volume of OTC Company securities and thereby increase the value of MedCap's portfolio.

10. Since MedCap itself had limited money to use for trading, Toney turned to his other fund, Offshore, to buy shares of OTC Company. Through Offshore, Toney purchased 161,500 shares of OTC Company from September 26-29. Toney's purchases pushed OTC Company's share price from $0.85 per share to $3.72 per share by the final trading day of the fund's quarter, quadrupling the value of the 10.3 million OTC Company shares held by MedCap and doubling the value of MedCap's total portfolio.

11. From September 26 to 29, Toney's purchases comprised nearly 60% of the total volume of OTC Company shares traded, making Offshore the largest retail purchaser of OTC Company stock. No shares of OTC Company traded on September 22 and September 25, the two trading days before Toney's purchases, demonstrating that there was little other retail interest in the stock. OTC Company's volume reverted back once Toney finished buying – fewer than 20,000 total shares traded during the first three days after Toney exited the market.

12. Toney placed orders for OTC Company at ever-increasing values at or above the "Inside Ask" price at the time of Toney's order.[2] By offering to buy shares of OTC Company in this way, Toney ensured that his orders would be executed. He thus showed the market sharply-increased demand and successively-increasing prices, as follows:

- On September 26, Toney purchased 18,000 shares of OTC Company, making up over 62% of the total trading volume for the day. By the end of day, OTC Company's price had increased from $0.85 to $1.30.
- On September 27, Toney purchased another 21,000 shares of OTC Company, representing nearly 40% of the total trading volume for the day. OTC Company's price increased for the second straight day, moving up from $1.30 to $1.55 per share.
- On September 28, Toney purchased another 55,000 shares of OTC Company, over 70% of the total trading volume. In response to Toney's purchases, OTC Company's price rose from $1.55 to $2.20 per share on September 28.
- On September 29, the last trading day of the quarter, Toney purchased 67,500 shares of OTC Company. This represented over 60% of the trading

[2] In the equity markets, the "Inside Ask" represents the lowest price at which a market participant will sell a stock at any given time. The "Inside Bid" price is the highest price that a market participant will pay to buy the stock.

volume for the day. OTC Company's price rose from $2.20 to $3.72 by the end of trading.

13. By the end of Toney's four-day purchases, the share price of OTC Company had risen from $0.85 to $3.72 per share, a 338% increase. Toney's buying pressure took the value of MedCap's OTC Company holdings from $8.8 million to $38.3 million, and the $29 million increase in MedCap's OTC Company holdings allowed the fund to report a third quarter portfolio value of $58 million.

14. After Toney completed his purchases (including 4,500 shares on October 3), OTC Company slowly but steadily returned to its previous price levels. On December 31, 2006, OTC Company's stock closed at $0.60 per share.

October 2006: Toney Reports to His Investors

15. On October 2, Toney e-mailed MedCap's investors to inform them of the fund's quarterly returns. While acknowledging a down quarter overall, Toney emphasized what he saw as cause for optimism:

> MedCap Partners L.P. Q3:06 performance results reflect some of the same, albeit not as damaging as we experienced in the prior quarter. For the quarter ending September, MedCap's preliminary estimated results are -17.7% with the month of August contributing the majority of the down quarter. One silver lining appeared later in September as many of our investments began to bounce (perhaps reflecting how truly undervalued they had become) and began to actually react better to good news (whereas before they have recently not been reacting at all or reacting negatively). We remain optimistic that our current investments will show improvements as companies continue to execute.

16. Toney's representation that MedCap's third quarter performance improved on its second quarter loss of 36.4% was almost entirely based on his quarter-end inflation of OTC Company's stock price. But for this price rise, precipitated by Toney's purchases of OTC Company through the Offshore fund, MedCap would have reported a 62% loss, not a 17.7% loss. In addition, Toney did not explain that most of the "bounce" in MedCap's investment value was the result of Toney's inflation of OTC Company's share price.

17. Since every $0.10 increase in OTC Company inflated the total MedCap portfolio by approximately $1 million, MMR and Toney received an additional $2,500 in management fees from MedCap for each $0.10 rise in OTC Company stock. In total, MMR and Toney collected $61,180.86 in additional MMR management fees due to OTC Company's quarter-end price spike.

18. Furthermore, Toney used the Offshore fund's cash to make large purchases of OTC Company stock, not because it was necessarily in the interests of Offshore, but rather so he could improve the reported value of the MedCap fund. Moreover, by buying the shares in a manner that caused OTC Company's stock price to quadruple over the course of Toney's purchases, Offshore paid higher-than-necessary prices for the OTC Company stock.

19. As a result of the conduct described above, MMR willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Toney willfully aided and abetted and caused MMR's violations of Sections 206(1) and 206(2) of the Advisers Act.

IV.

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

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

A. Respondents MMR and Toney cease and desist from committing or causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act;

B. Respondent Toney be, and hereby is, barred from association with any investment adviser, with the right to reapply for association after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission;

C. Respondent MMR is censured.

D. Any reapplication for association by Respondent Toney will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Toney, 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.

E. IT IS FURTHER ORDERED that Respondent MMR shall, within 30 days of the entry of this Order, pay disgorgement of $61,180.86 and prejudgment interest of $9,452.83 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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 MMR 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 Marc J. Fagel, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

F. It is further ordered that Respondent Toney shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 Toney 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 Marc J. Fagel, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

By the Commission.

Florence E. Harmon
Acting Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Aguilar not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 58802 / October 17, 2008

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2803 / October 17, 2008

Admin. Proc. File No. 3-12832

In the Matter of

JUSTIN F. FICKEN
c/o Gary G. Pelletier
Denner Pellegrino, LLP
Four Longfellow Place, 35th Floor
Boston, Massachusetts 02114

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Injunction

Former associated person of registered broker-dealer and investment adviser was 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:

Gary G. Pelletier and Brad Bailey, of Denner Pellegrino, LLP, for Justin F. Ficken.

Frank C. Huntington, for the Division of Enforcement.

Appeal filed: March 13, 2008
Last brief received: September 23, 2008

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I.

Justin F. Ficken, an associated person of Prudential Securities, Inc. (PSI), formerly a broker-dealer and investment adviser registered with the Commission, appeals from a decision of an administrative law judge. The law judge barred Ficken from association with any broker, dealer, or investment adviser based on Ficken's injunction from violations of the antifraud provisions of the federal securities laws. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

This administrative proceeding is based on an injunctive proceeding brought by the Commission against Ficken and others in the United States District Court for the District of Massachusetts in November 2003, alleging that they had used fraudulent and deceptive practices to help their customers engage in "market timing" of mutual fund shares. 1/ On August 14, 2007, the district court granted the Commission's motion for summary judgment against Ficken. 2/ On September 13, 2007, the court entered a final judgment against Ficken, permanently enjoining him from violations of Section 17(a) of the Securities Act of 1933, 3/ Section 10(b) of the Securities Exchange Act of 1934, 4/ and Exchange Act Rule 10b-5. 5/ The district court also ordered Ficken to disgorge $589,854, including prejudgment interest. Ficken has appealed the district court's final judgment to the United States Court of Appeals for the First Circuit. 6/

The district court found that, sometime between 2000 and 2001, Ficken became affiliated with a brokerage team at PSI led by Martin Druffner (the "Druffner Group"). The court determined that, from January 2001 to September 2003, the Druffner Group, including Ficken,

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1/ Market timing is a "trading strategy in which traders rapidly buy and sell mutual fund shares to exploit brief discrepancies between the official stock prices used to determine[] the value of the mutual fund shares, and the prices at which those stocks are actually trading." SEC v. Druffner, 517 F. Supp. 2d 502, 506 (D. Mass. 2007).

2/ Druffner, 517 F. Supp. 2d at 502.

3/ 15 U.S.C. § 77q(a).

4/ 15 U.S.C. § 78j(b).

5/ 17 C.F.R. § 240.10b-5.

6/ SEC v. Ficken, No. 07-2532 (1st Cir. Oct. 24, 2007). In addition, on September 15, 2008, Ficken pled guilty to criminal charges, including two counts of securities fraud, arising from the same conduct at issue in the Commission's underlying civil injunctive action. United States v. Ficken, No. 1:07-cr-10427-PBS (D. Mass. Sept. 15, 2008).

utilized various fraudulent practices to help their clients engage in market timing. The court found that Ficken "misrepresented the nature of his and the Druffner Group's transactions to the mutual funds" whose securities they were buying and selling. 7/ The court further found that the Druffner Group used a total of 13 different broker numbers (called "FA" numbers, for "financial advisor" numbers) and over 170 brokerage accounts to carry out numerous market timing transactions, despite the fact that the Druffner Group had only five clients. Many "of those fictitious FA numbers and accounts were registered individually or jointly under Ficken's name." 8/ The court also found that the accounts that the mutual funds blocked to prevent market timing "were replaced by new accounts many of which were registered under Ficken's name." 9/ In light of this evidence, the court concluded that Ficken "clearly misrepresented the nature of his and the Druffner Group's transactions to the mutual funds." 10/

The court determined that Ficken's misrepresentations were material because, "[h]ad it not been for such misrepresentations, the mutual funds would not have allowed the [market timing] transactions undertaken by [Ficken]." 11/ In support of this finding, the court noted that the record showed that mutual funds had asked PSI repeatedly to forbid Ficken and his co-defendants from engaging in their market timing activities 12/ and that mutual funds had endeavored to prohibit rapid transactions within individual accounts in order to stop market timing. However, these efforts were defeated by the defendants' use of multiple FA numbers and accounts which concealed the true identities of the defendants.

7/ Druffner, 517 F. Supp. 2d at 508.

8/ Id.

9/ Id.

10/ Id.

11/ Id. at 508-09.

12/ As an example of the mutual fund companies' efforts to stop Ficken and the Druffner Group's market timing activities, the court cited to an August 9, 2001 email that Hartford Mutual Funds sent to Ficken "informing him he could not open new accounts place trades, or receive trail commissions after September 10, 2001." Id. at 509. The email stated:

> We have sent you warnings that your trading behavior violates the policies and procedures established by The Hartford Mutual Funds, and we have terminated your exchange privileges on more than one occasion. Despite the warnings and terminations, you simply close one account and open another account. And, you continue to violate our prohibitions on market timing.

Id.

The court further found that Ficken acted with scienter. The court found that the record contained "ample evidence indicating that [Ficken's] actions were intentionally geared toward evading detection by the mutual fund managers." 13/ The court determined that Ficken engaged in his market timing activities, despite receiving numerous emails from mutual fund representatives directing him and his co-defendants to stop these activities. The court also observed that the email communications between Ficken and his clients advising them on ways to avoid detection reflected Ficken's awareness of his misrepresentations to the mutual funds. 14/ The court concluded that an injunction was proper because Ficken had "engaged in fraudulent activities over an extended period of time;" his "violations were flagrant, deliberate and part of a pattern;" and they were "motivated by the prospect of financial gain." 15/

On September 26, 2007, we instituted this administrative proceeding against Ficken. On February 20, 2008, the law judge granted the Division of Enforcement's motion for summary disposition and barred Ficken from association with any broker, dealer, or investment adviser. 16/ The law judge found that, based on the district court's findings, Ficken's conduct was "egregious and recurrent" and evidenced a "high degree of scienter." Moreover, the law judge found that Ficken had not admitted the wrongful nature of his conduct, nor had he made any assurances against future violations. The law judge further noted that the bar would serve the public interest as Ficken's "continued employment in the securities industry will present Ficken additional opportunities to violate securities laws." This appeal followed.

III.

Under Exchange Act Sections 15(b)(4) and (6) 17/ and Advisers Act Sections 203(e) and (f), 18/ 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 has been permanently enjoined from engaging in any conduct or practice in connection

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13/ Id.

14/ For example, the court noted that, on November 29, 2002, Ficken sent an email to a market-timing customer with several recommendations, including the purchase of $40,000 of Pioneer mutual funds through two accounts, explaining that, "Pioneer doesn't monitor trades under $25,000 so I figure we can do $20,000 in both accounts." Id. at 509.

15/ Id. at 513.

16/ Justin F. Ficken, Initial Decision Rel. No. 345 (Feb. 20, 2008), 92 SEC Docket 2627.

17/ 15 U.S.C. §§ 78o(b)(4) and (6).

18/ 15 U.S.C. §§ 80b-3(e) and (f).

with the purchase or sale of securities. Ficken does not dispute that a permanent injunction has been entered against him.

In determining the appropriate remedial sanction, we are guided by the following factors:

> [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. 19/

We have stated "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." 20/ "Fidelity to the public interest" requires a severe sanction when a respondent's misconduct involves fraud because the "securities business is one in which opportunities for dishonesty recur constantly." 21/ Moreover, "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." 22/ Based on a consideration of the relevant factors, and all of the circumstances in this case, we find that the public interest requires that Ficken be barred.

The district court found that Ficken, "motivated by the prospect of financial gain, engaged in fraudulent activities over an extended period of time." From January 2001 until September 2003, Ficken registered multiple fictitious mutual fund trading accounts under his FA number, facilitating thousands of fraudulent market timing trades. As the district court noted, "[u]sing a multitude of FA numbers and accounts was a method of concealing the true identities of the defendant and the Druffner Group. Had it not been for such misrepresentations, the mutual funds

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

20/ Robert Radano, Investment Advisers Act Rel. No. 2750 (June 30, 2008), __ SEC Docket ____, ____ n.76; Jose P. Zollino, Exchange Act Rel. No. 55107 (Jan. 16, 2007), 89 SEC Docket 2598, 2608; Marshall E. Melton, 56 S.E.C. 695, 713 (2003). As we emphasized in Radano, supra, "fraud violations typically warrant the most severe sanctions."

21/ Richard C. Spangler, Inc., 46 S.E.C. 238, 252 (1976).

22/ Melton, 56 S.E.C. at 713. As we noted in Melton, 56 S.E.C. at 710, "an antifraud injunction can, in the first instance, indicate the appropriateness in the public interest of revocation of registration or a suspension or bar from participation in the securities industry."

would not have allowed the transactions undertaken by [Ficken]." 23/ We, accordingly, find that Ficken's actions were both egregious and recurrent.

We further find that Ficken acted with a high degree of scienter. As the district court concluded, "[t]he record contains ample evidence indicating that [Ficken's] actions were intentionally geared toward evading detection by the mutual fund managers." 24/ Ficken sent numerous emails to his market timing clients advising them on ways to avoid detection by the mutual fund companies. He received several letters and emails from the mutual fund companies demanding that he stop his market timing activities. 25/ The district court found that Ficken's violations were "motivated by the prospect of financial gain." 26/

Ficken argues that he was a relatively minor participant in the scheme who unfairly received a harsher sanction than that imposed on other individuals who were "far more culpable" than he, either by virtue of their seniority or the extent of their activities. For example, Ficken compares his situation to that of Charles Sacco, a former registered representative of A.G. Edwards & Sons, Inc., who settled an administrative proceeding concerning his market timing activity, consenting to an order barring him from association with a broker, dealer, or investment adviser with a right to reapply after two years. 27/ Ficken contends that his alleged conduct "did not compare with that of Charles Sacco" because Sacco, "the king of financial account numbers" and the "dean of market timing" at A.G. Edwards, executed "far more trades than Ficken ever did." Ficken also compares his sanction to that of John S. Peffer, a registered PSI representative and co-defendant in the underlying injunctive action. Peffer consented to the entry of a final judgment in the underlying action. He also settled an administrative proceeding, consenting to an order barring him from associating with a broker, dealer, or investment adviser with a right to reapply after three years. 28/ Ficken argues that he should not receive a harsher sanction than

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23/ 517 F. Supp. 2d at 508-09.

24/ Id. at 509.

25/ See Jeffrey L. Gibson, Exchange Act Rel. No, 57266 (Feb. 4, 2008), 92 SEC Docket 2104, 2109, appeal filed, No. 08-3377 (6th Cir. Apr. 3, 2008) (finding an associated person's actions to disguise his misconduct from investors was evidence that the person acted with scienter).

26/ 517 F. Supp. 2d at 513.

27/ Charles A. Sacco, Exchange Act Rel. No. 55693 (May 2, 2007), 90 SEC Docket 1572.

28/ John S. Peffer, Exchange Act Rel. No. 52962 (Dec. 16, 2005), 86 SEC Docket 3078.

Peffer, who was a supervisor at PSI, and who committed a "similar number of trades using multiple FA numbers." 29/

Ficken's arguments are without merit. It is well established that the determination of the appropriate sanction depends on the facts and circumstances of each case and is not dependent on the sanctions imposed in other cases. 30/ Moreover, parties that settle disciplinary proceedings often receive less severe sanctions than those who do not. 31/ Accordingly, we reject Ficken's contention that we should reduce his sanction based on sanctions imposed in settlements with other market-timing participants.

Ficken also faults the law judge for ignoring the Division's "bad faith . . . in targeting him simply because he lacked the financial wherewithal to propose a satisfactory monetary settlement offer" in the underlying injunctive proceeding. He asserts that, while PSI "bought its way out of an indictment by agreeing to pay $600 million into the government's coffers, the individual PSI

29/ The Division counters that the Ficken team's market-timing activities were more extensive than that engaged in by Sacco and Peffer and that Ficken received a larger financial benefit from his market-timing activities than did the others. The Division also argues that Ficken "cherry-pick[ed]" the cases he cited to make his argument, while "ignor[ing] the fact that several other registered representatives in market timing cases (including Ficken's two teammates) have also received bars from association with a broker-dealer or investment advisor without any [right to reapply after a period of time]."

30/ See Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Geiger v. SEC, 363 F.3d 481, 488 (D.C. Cir. 2004) (stating that "[t]he Commission is not obligated to make its sanctions uniform . . . [and the Court] will not compare [a] sanction to those imposed in previous cases"); Radano, __ SEC Docket at ____ n.76.

31/ Schon-Ex, LLC, Exchange Act Rel. No. 57857 (May 23, 2008), __ SEC Docket ___, ___ n. 24. See also Phlo Corp., Exchange Act Rel. No. 55562 (Mar. 30, 2007), 90 SEC Docket 1089, 1113 n.84 (noting that "the rationale for the imposition of lower sanctions in settled proceedings is, at least in part, that settlement lets the Commission avoid time-consuming adversary proceedings and the concomitant expenditure of staff resources"); Philip A. Lehman, Exchange Act Rel. No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 550 (pointing out that sanctions imposed in settled proceedings may understate the sanctions imposed in litigated cases "because settled sanctions reflect pragmatic considerations such as the avoidance of time-and-manpower- consuming adversarial litigation"); Richard J. Puccio, 52 S.E.C. 1041, 1045 (1996) (noting that "respondents who offer to settle may properly receive lesser sanctions than they otherwise might have received based on pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings") (citation omitted).

brokers targeted in the criminal probe "could not bribe the government with hundreds of millions of dollars to escape prosecution" and thus "did not have the buyout option that PSI did." 32/

Ficken has offered no evidence to support his assertion that the Division acted in bad faith. The Commission is not required to accept any settlement offer in one of its proceedings. 33/ Moreover, this is not the appropriate forum for challenging the propriety of the Division's conduct in connection with a potential settlement of the injunctive action. Such a challenge should have been brought before the district court and, if necessary, appealed. 34/

Ficken's actions constituted "an egregious abuse of the trust placed in him as a securities professional." 35/ Moreover, Ficken's failure to acknowledge the wrongful nature of his actions or to show remorse indicates that there is a significant risk that, given the opportunity, Ficken would commit further misconduct in the future. Absent a bar, he could seek to reenter the securities industry through an association with another broker, dealer, or investment adviser.

32/ Ficken's assertion relates to a global civil and criminal settlement reached between Prudential Equity Group, LLC (PEG), the successor to PSI, and the United States Attorney's Office for the District of Massachusetts, the Commission, the Massachusetts Securities Division, NASD, the New Jersey Bureau of Securities, the New York Attorney General's Office and the New York Stock Exchange. Under the settlement, PEG agreed to pay a total of $600 million: $270 million to a distribution fund administered by the Commission for the benefit of those harmed by the fraud; $325 million as a criminal penalty to the U.S. Department of Justice; and $5 million as a civil penalty to the Massachusetts Securities Division. See SEC Press Release 2006-145, Prudential to Pay $600 Million in Global Settlement of Fraud Charges in Connection With Deceptive Market Timing of Mutual Funds; Commission Also Charges Four Individuals with Fraud (Aug. 28, 2006), http://www.sec.gov/news/press/2006/2006-145.htm.

33/ See A.J. White & Co. v. SEC, 556 F.2d 619, 625 (1st Cir. 1977) (in rejecting contention that it was improper for Commission to decline to accept petitioners' settlement offers, the court stated that "[l]itigants are never required to accept settlement offers").

34/ James E. Franklin, Exchange Act Rel. No. 56649 (Oct. 12, 2007), 91 SEC Docket 2708, 2713-14, petition denied, 2008 U.S. App. LEXIS 15246 (D.C.Cir. 2008) (per curiam); Harold F. Harris, Exchange Act Rel. No. 53122A (Jan. 13, 2006), 87 SEC Docket 362, 3701.

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

Accordingly, under the circumstances, we have determined that barring Ficken serves the public interest and is remedial. 36/

An appropriate order will issue. 37/

By the Commission (Chairman COX and Commissioners CASEY, WALTER, and PAREDES); Commissioner AGUILAR not participating.

Florence E. Harmon
Acting Secretary

By: J. Lynn Taylor
Assistant Secretary

36/ See Gibson, 92 SEC Docket at ____ (respondents in follow-on case barred based on antifraud injunction); Michael Batterman, 57 S.E.C. 1031 (2004) (same); Michael T. Studer, 57 S.E.C. 890 (2004) (same); Nolan Wayne Wade, 56 S.E.C. 748 (2003) (same); Christopher A. Lowry, 55 S.E.C. 1133 (2002) (same). Ficken does not assert that any factors mitigate his misconduct and we do not find any support in the record for a claim of mitigation.

37/ 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. 58802 / October 17, 2008

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2803 / October 17, 2008

Admin. Proc. File No. 3-12832

In the Matter of

JUSTIN F. FICKEN
c/o Gary G. Pelletier
Denner Pellegrino, LLP
Four Longfellow Place, 35th Floor
Boston, Massachusetts 02114

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Justin F. Ficken be, and he hereby is, barred from association with any broker, dealer, or investment adviser.

By the Commission.

Florence E. Harmon
Acting Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 17, 2008

In the Matter of **e-Smart Technologies, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that the public interest and the protection of investors require a suspension of trading in the securities of e-Smart Technologies, Inc. ("e-Smart," trading symbol ESMT). Questions have arisen concerning the accuracy and adequacy of publicly-available information about the company, particularly concerning: (1) e-Smart's statements concerning a large supply contract for 20 million units of its product, contained in a February 26, 2008 press release, a March 13, 2008 Current Report on Form 8-K and a May 15, 2008 news article, all of which are available on e-Smart's website; and (2) e-Smart's failure to make required periodic filings with the Commission of information required pursuant to the Securities Exchange Act of 1934 for any period since the period ending September 30, 2007. Questions have also arisen concerning a possible distribution of e-Smart's common stock without registration under the Securities Act of 1933.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period of 9:30 a.m. EDT on October 17, 2008 through 12:59 p.m. EDT on October 30, 2008.

By the Commission.

Florence E. Harmon
Acting Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-8977; 34-58788; IC-28438; IA-2798]

RESUBMISSION OF COMMENT LETTERS

AGENCY: Securities and Exchange Commission

ACTION: Resubmission of comments.

SUMMARY: A small number of public comments submitted by commenters in connection with certain proposed Commission rules, proposed rule changes by self-regulatory organizations, and other matters were not received by the Commission through the Federal eRulemaking Portal and through the Commission's Web site due to software issues. A list of those matters and the number of comment letters not received is attached as Appendix A. The Commission is providing an opportunity for commenters whose comments were not received to resubmit their comments with respect to the matters identified in Appendix A.

DATES: Resubmit comments on or before October 29, 2008.

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

Electronic Comments

- Use the Commission's Internet submission form (http://www.sec.gov/rules/other.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include the file number for the specific matter being commented upon on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments

- Send paper statements in triplicate to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549–1090.

All submissions should refer to the file number for the specific matter being commented upon. 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/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, on official business days between the hours of 10:00 am and 3:00 pm. 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: Florence E. Harmon, Acting Secretary, at (202) 551-5400, Office of the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549–1090.

SUPPLEMENTARY INFORMATION: A small number of public comments submitted by commenters in connection with the matters identified in Appendix A were not received by the Commission through the Federal eRulemaking Portal and through the Commission's Web site due to software issues. The Commission has been informed by the agency responsible for the Federal eRulemaking Portal and the staff responsible for maintaining the Commission's Web site that these issues have been resolved. The

Commission is providing an opportunity for commenters to resubmit those comments.[1] Because the identities of the commenters whose submissions were affected by these software issues are not retrievable, the Commission requests that if you commented on any of the matters listed in Appendix A you review the Commission's Web site posting for the particular matter to determine whether your comment letter has been posted. If it has not been posted and you wish to resubmit your comment letter, you may do so via any of the methods described above. If your comment letter has been posted, there is no need to resubmit it.

The Commission will consider all comment letters that are resubmitted. Although the Commission has taken action on some of these matters, the Commission will evaluate whether further action is necessary or appropriate in response to comments received.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 15, 2008

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1 The Commission recently reopened the comment period for one of the matters listed in Appendix A, Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release No. 8933 (June 25, 2008) (73 FR 37752 (July 1, 2008)). Any commenters whose comments on this matter were not received can resubmit comments until the end of the reopened comment period. See Indexed Annuities and Certain Other Insurance Contracts, Securities Act Release No. 8976 (Oct. 10, 2008).

APPENDIX A

List of Matters and Number of Comment Letters Not Received

- References to Ratings of Nationally Recognized Statistical Rating Organizations (File No. S7-19-08) [3 comments]
- Security Ratings (File No. S7-18-08) [2 comments]
- References to Ratings of Nationally Recognized Statistical Rating Organizations (File No. S7-17-08) [2 comments]
- Exemption of Certain Foreign Brokers or Dealers (File No. S7-16-08) [3 comments]
- Modernization of the Oil and Gas Reporting Requirements (File No. S7-15-08) [6 comments]
- Indexed Annuities and Certain Other Insurance Contracts (File No. S7-14-08) [37 comments]
- Interactive Data to Improve Financial Reporting (File No. S7-11-08) [1 comment]
- Amendment to Regulation SHO (File No. S7-19-07) [18 comments]
- Naked Short-Selling Anti-Fraud Rule (File No. S7-08-08) [4 comments]
- Revisions to the Cross-Border Tender Offer, Exchange Offer, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions (File No. S7-10-08) [1 comment]
- Commission Guidance Regarding the Duties and Responsibilities of Investment Company Board of Directors with respect to Investment Adviser Portfolio Trading Practices (File No. S7-22-08) [1 comment]
- Roundtable on Fair Value Accounting Standards (File No. 4-560) [1 comment]

- Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending its Schedule of Fees and Charges for Exchange Services in order to Revise Certain Transaction Fees (File No. SR-NYSEARCA-2008-75) [1 comment]
- Notice of Filing of Proposed Rule Change of Amended Proposed Rule Change Amending FAST and DRS Limited Participant Requirements for Transfer Agents (File No. SR-DTC-2006-16) [1 comment]

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-8980; 34-58813; File No. 4-573]

Roundtable on Mark-to-Market Accounting

AGENCY: Securities and Exchange Commission.

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: On October 29, 2008 from 9:00 am to 1:00 pm, the Securities and Exchange Commission will hold a roundtable to discuss mark-to-market accounting and the recent period of market turmoil. The roundtable will be organized as two panels. The panels will include investors, issuers, auditors, and other parties with experience in mark-to-market accounting. Additionally, representatives from the Financial Accounting Standards Board, the International Accounting Standards Board and the Public Company Accounting Oversight Board will be present as observers.

The roundtable will be held in the auditorium of SEC headquarters at 100 F Street, NE, Washington, DC. The roundtable will be open to the public with seating on a first-come, first-served basis. The roundtable discussions also will be available via webcast on the SEC's Web site at www.sec.gov. The roundtable agenda and other materials related to the roundtable, including a list of participants and moderators, will be accessible at http://www.sec.gov/spotlight/fairvalue.htm. The Commission welcomes feedback regarding any of the topics to be addressed at the roundtable.

DATES: Comments should be received on or before October 28, 2008.

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

Electronic Comments

- Use the Commission's Internet submission form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-573 on the subject line.

Paper Comments

- Send paper comments in triplicate to Florence Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549–1090.

All submissions should refer to File No. 4-573. 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 also will be available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; 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: Bert Fox or Liza McAndrew Moberg, Professional Accounting Fellows, at (202) 551-5300, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6561.

SUPPLEMENTARY INFORMATION: The Commission welcomes feedback regarding any of the topics to be addressed at the roundtable. The panel discussions will focus on:

- The effects of mark-to-market accounting on financial reporting by financial institutions.
- Potential market behavior effects from mark-to-market accounting.
- The usefulness of mark-to-market accounting to investors and regulators.
- Aspects of the current accounting standards that can be improved.

By the Commission.

Florence E. Harmon
Acting Secretary

Dated: October 20, 2008

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey and Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58815 / October 20, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13277

In the Matter of

ANNE B. LIEBERMANN,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Anne B. Liebermann ("Liebermann" 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 her and the subject matter of these proceedings and the findings contained in Section III. 2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Respondent Anne B. Liebermann, age 43, is a resident of Denver, Colorado. Respondent is not and has never been associated with a broker-dealer registered with the Commission.

2. On October 7, 2008, a final judgment was entered by consent against Liebermann, permanently enjoining her from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"); Sections 10(b) and 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Jarrod McMillin, et al., Civil Action Number 07cv2636-REB-MEH in the United States District Court for the District of Colorado.

3. The Commission's complaint alleged that, in connection with the sale of advertising program interests in American Investors Network ("AIN") and Fairweather Management ("Fairweather"), which were securities in the form of investment contracts, Liebermann solicited funds from investors as part of the operation of an illegal Ponzi scheme; made false and misleading statements to investors about AIN and Fairweather's business, profits, and use of investor funds; continued to solicit investors after learning of the Commission's investigation of AIN; and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that Liebermann sold unregistered 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 Liebermann's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Liebermann be, and hereby is barred from association with any broker, dealer, or 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 Liebermann 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.

Florence E. Harmon
Acting Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 28464 / October 23, 2008

In the Matter of

EATON VANCE FLOATING-RATE INCOME TRUST
EATON VANCE SENIOR FLOATING-RATE TRUST
EATON VANCE SENIOR INCOME TRUST
EATON VANCE CREDIT OPPORTUNITIES FUND
EATON VANCE LIMITED DURATION INCOME FUND

255 State Street
Boston, MA 02109

(812-13540)

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING AN EXEMPTION FROM SECTIONS 18(a)(1)(A) AND (B) OF THE ACT

Eaton Vance Floating-Rate Income Trust, Eaton Vance Senior Floating-Rate Trust, Eaton Vance Senior Income Trust, Eaton Vance Credit Opportunities Fund, and Eaton Vance Limited Duration Income Fund filed an application on June 10, 2008 and amendments to the application on July 2, 2008, July 29, 2008, and September 2, 2008, requesting an order under section 6(c) of the Investment Company Act of 1940 (Act) for an exemption from sections 18(a)(1)(A) and (B) of the Act. The order would permit the applicants, for a period of two years immediately following the date of this order, subject to asset coverage of 200%, (1) to issue a class of senior securities representing indebtedness and redeem its issued and outstanding auction preferred shares, and (2) to declare dividends and or other distributions on its capital stock.

On October 2, 2008, a notice of the filing of the application was issued (Investment Company Act Release No. 28431). 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 and consistent with 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 Eaton Vance Floating-Rate Income Trust, *et al.*, (File No. 812-13540),

IT IS ORDERED, under section 6(c) of the Act, that the requested exemption from sections 18(a)(1)(A) and (B) of the Act is granted, effective immediately, subject to the conditions contained in the application, as amended.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-28465; 812-13576]

The Reserve Fund; Notice of Application

October 24, 2008

Agency: Securities and Exchange Commission ("Commission").

Action: Notice of application for a temporary order under Section 22(e)(3) of the Investment Company Act of 1940 (the "Act").

Summary of Application: Applicant filed an application for a temporary order to permit two of its series to suspend the right of redemption of their outstanding redeemable securities and to postpone payment for shares which have been submitted for redemption for which payment has not been made. The Commission issued an order on September 22, 2008 granting the requested order and is now providing an opportunity for interested persons to request a hearing.

Applicant: The Reserve Fund (the "Applicant"), on behalf of two of its series, the Primary Fund and the U.S. Government Fund (the "Funds").

Filing Date: The application was filed on September 22, 2008.

Hearing or Notification of Hearing: Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicant with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 pm on [insert date 15 days after date of publication in the Federal Register], and should be accompanied by proof of service on Applicant, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicant, 1250 Broadway, New York, NY 10001-3701.

For Further Information, Contact: Brian P. Murphy, Senior Counsel, at (202) 551-6825 (Division of Investment Management, Office of Chief Counsel).

Supplementary Information: The complete application may be obtained for a fee at the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1520 (tel. 202-551-5850).

Based on the representations provided by the Applicant in its application, including those relating to the current extraordinary market conditions and the actions by the Funds' board of trustees (the "board") on September 17th, the Commission issued an Order on September 22, 2008 pursuant to Section 22(e)(3) of the Act as requested by the Applicant (the "Order").[1] Under the circumstances described in the Order, which required immediate action in order to protect Fund shareholders, the Commission concluded that it was not practicable to give notice or an opportunity to request a hearing before it issued the Order and that the Order should be effective as of the date of the actions of the Funds' board. The Commission is now providing an opportunity for interested persons to request a hearing.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

[1] In the Matter of the Reserve Fund, Investment Company Act Release No. 28386 (Sept. 22, 2008).

Commissioner Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58849 / October 24, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2896 / October 24, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13278

In the Matter of **Barry Schechter, C.A.** **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 Barry Schechter ("Respondent" or "Schechter") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . 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

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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 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 ("Order"), as set forth below.

III.

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

1. Schechter, age 54, is a resident of La Jolla, California. In 1990, Schechter founded the company that eventually became Island Pacific, Inc. Schechter was CEO of Island Pacific from its inception to January 2001, October 2001 to June 2003, and April 2005 to June 2008. He was Chairman of the Board of Directors of Island Pacific from February 1994 to July 2003. From approximately August 2003 through January 2005, Schechter was designated as a consultant to Island Pacific. During this period, Schechter was a controlling person of Island Pacific and controlled a substantial number of its shares. Schechter was a Chartered Accountant in South Africa from 1979 to 1989, when he emigrated to the United States and allowed his license to lapse. On June 4, 2008, Island Pacific announced that Schechter had resigned from his CEO and director positions effective that day but that Schechter would continue to handle special projects on a part-time basis.

2. Retail Pro, Inc. (formerly known as Island Pacific, Inc.) was, at all relevant times, a Delaware corporation with its principal place of business in Southern California. Island Pacific was engaged in the business of developing and selling computer software to the retail industry. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, traded on the American Stock Exchange until it was delisted on October 25, 2005, for failing to file periodic reports, and currently trades through Pink OTC Markets, Inc. (RTPR.PK). On December 21, 2007, Island Pacific sold its Island Pacific division to an Australian company and renamed the unsold portion of the company Retail Pro, Inc.

3. On October 16, 2008, a final judgment was entered against Schechter, 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 Securities Exchange Act of 1934 ("Exchange Act"), and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and from aiding and abetting any violation of Section

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the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

13(a) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Retail Pro, Inc. (fka Island Pacific, Inc.) et. al, Civil Action Number 08 CV 1620 WQH (RBB), in the United States District Court for the Southern District of California. Schechter was also ordered to pay $488,410 in disgorgement of ill-gotten gains from his sales of stock while participating in the unlawful conduct, and $27,437 in prejudgment interest, and a $120,000 civil money penalty.

4. The Commission's Complaint alleged, among other things, that Schechter participated in Island Pacific's financial fraud from the quarter ended September 30, 2003, through the fiscal year ended March 31, 2004, in which Island Pacific recognized $3.9 million from a non-monetary transaction with QQQ Systems Pty Limited ("QQQ") in violation of Generally Accepted Accounting Principles; overstated its quarterly revenues by 140% and reported a small profit instead of a $3.1 million loss for the quarter ended September 30, 2003; overstated its annual revenues by 22% and understated its losses by 47% for the fiscal year ended March 31, 2004; and failed to disclose the non-monetary nature of the transaction with QQQ in its periodic reports, earnings press releases, and its earnings conference call with analysts and shareholders. The Complaint alleged that Schechter participated in the financial fraud by, among other things, negotiating the non-monetary transaction with QQQ, approving the improper recognition of revenue, reviewing and approving Island Pacific's earnings press release and scripts for the conference calls, and providing false information to Island Pacific's auditor in connection with the audit of Island Pacific's fiscal year 2004 audit. The Complaint further alleged that Schechter profited from the financial fraud by selling through a trust he controlled 637,750 shares of Island Pacific stock.

IV.

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

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

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

By the Commission.

Florence E. Harmon
Acting Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58845; File No. SR-NYSE-2008-46)

October 24, 2008

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment Nos. 2 and 3 and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3, to Create a New NYSE Market Model, with Certain Components to Operate as a One-Year Pilot, That Would Alter NYSE's Priority and Parity Rules, Phase Out Specialists by Creating a Designated Market Maker, and Provide Market Participants with Additional Abilities to Post Hidden Liquidity

I. Introduction

On June 12, 2008, the New York Stock Exchange LLC[1] ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[2] and Rule 19b-4 thereunder,[3] a proposed rule change to establish a new market model ("New Model"). The New Model would implement significant changes in NYSE's market structure, including, most notably: (i) the phasing out of the specialist system and adopting a Designated Market Maker ("DMM") structure; (ii) the alteration of NYSE's priority and parity rules, most significantly to allow DMMs to trade on parity with orders on NYSE's Display Book® ("Display Book"); and (iii) the introduction of new order functionality, including the DMM Capital Commitment Schedule ("CCS") and hidden orders.[4]

On July 15, 2008, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for public comment

1 Formerly known as the New York Stock Exchange, Inc.

2 15 U.S.C. 78s(b)(1).

3 17 CFR 240.19b-4.

4 Currently, specialists must yield to customer orders on the Display Book. See NYSE Rule 92(a).

in the Federal Register on July 23, 2008.[5] The Exchange filed Amendment No. 2 to the proposed rule change on August 29, 2008. The Exchange filed Amendment No. 3 to the proposed rule change on October 7, 2008. The Commission received no comment letters regarding proposed rule change. This order provides notice of filing of Amendment Nos. 2 and 3 to the proposed rule change, and grants accelerated approval to the proposed rule change, as modified by Amendment Nos. 1, 2 and 3.

II. Description of the Proposal

A. Background: NYSE's Hybrid Market and the Evolution of Electronic Trading

Section 11(b) of the Act[6] allows the rules of a national securities exchange to permit a member to be registered as a specialist and act as both a broker and a dealer. Historically, the NYSE specialist was responsible for overseeing the execution of all orders coming into the Exchange, for conducting auctions on the Floor, and for maintaining an orderly market in assigned securities. Specialists' dealer activities are governed, in part, by the negative and affirmative trading obligations. Rule 11b-1 under the Act[7] requires exchanges that permit members to register as specialists to have rules governing specialists' dealer transactions so that their proprietary trades conform to the negative and affirmative obligations. The negative obligation as set forth in Rule 11b-1 under the Act requires that a specialist's dealings be restricted, so far as practicable, to those reasonably necessary to permit the specialist to maintain a fair and orderly market.[8] The affirmative obligation as set forth in Rule 11b-1 under the Act requires a specialist to engage in a course of dealings for its own account to assist in the

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5 Securities Exchange Act Release No. 58184 (Jul. 17, 2008), 73 FR 42853 ("Notice").

6 15 U.S.C. 78k(b).

7 17 CFR 240.11b-1.

8 17 CFR 240.11b-1(a)(2)(iii).

maintenance, so far as practicable, of a fair and orderly market.[9] NYSE has adopted these obligations in its current Rule 104.[10] In 2006, the Exchange began implementation of its NYSE HYBRID MARKET[SM] ("Hybrid Market"),[11] under which Exchange systems assumed the function of matching and executing electronically-entered orders. As part of the Hybrid Market, the Exchange programmed its systems to provide specialists with an order-by-order advance "look" at incoming orders.

The rise of the electronic Hybrid Market has fundamentally altered NYSE's trading environment. Traditionally, price discovery on the Exchange took place almost exclusively on the Floor in the form of face-to-face interactions among brokers and specialists. These interactions have diminished as electronic trading has become more important on the Exchange.

In addition, information that once was exclusive to the Floor, such as the most up-to-date quotes and last sale prices, is now widely available off the Floor through electronic means. At the same time, the Exchange believes that it is no longer the dominant trading market for many NYSE-listed securities, as competition from other market centers has increased.

The increase in electronic executions on the Exchange as well as the increase in the use of smart routing engines by market participants of all types has reduced the advantages once enjoyed by Floor brokers and specialists. Indeed, NYSE has argued that the informational advantage has shifted "upstairs" where orders are now first "shopped" within a firm and then to

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9 17 CFR 240.11b-1(a)(2)(ii).

10 NYSE Rule 104(a) reflects NYSE's adoption of the negative obligation and states that "no specialist shall effect on the Exchange purchases or sales of any security in which such specialist is registered, for any account in which he or his member organization . . . is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market . . ."

11 See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (SR-NYSE-2004-05).

others before being sent to the Floor for execution and, even then, orders are likely to be sent in pieces to multiple markets.[12]

Because of these changes, NYSE is proposing to adopt its New Model, which the Exchange believes would provide a more robust trading model on the Floor while preserving the existing framework for trading and some of the key responsibilities of its market participants that NYSE believes make it unique. The Exchange believes that the proposed changes would improve market quality in the form of tighter spreads, greater liquidity, and opportunities for price improvement.

B. Proposed Changes to Exchange Systems

1. Overview of NYSE's Proposed New Model

The Exchange proposes to eliminate the "specialist" category of market participants and create a new category of market participants, DMMs.[13] The Exchange intends to implement the New Model in two phases: Phase 1, beginning as of the date of this order ("Approval Date") and ending no more than five weeks after the Approval Date, and Phase 2, beginning upon completion of the Phase 1 implementation and ending no more than ten weeks after the Approval Date.[14] Though DMMs would still be "specialists" during Phase 1, once Phase 1 has been fully implemented and Phase 2 begins, DMMs would no longer be "specialists" under the Act. Once Phase 2 has been implemented, DMMs would no longer serve on the Exchange in the capacity of

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12 See Notice, supra note 5, at 42861.

13 See infra Section II.B.2.(a) for a more detailed description of the Exchange's proposal regarding DMMs.

14 The Exchange proposes to roll out each phase of the New Model initially in three or four securities, with progressive implementation of the New Model rules for additional securities over the duration of each phase. Certain provisions of the proposed rules for the New Model would be implemented on a one-year pilot basis. See infra Section II.B.5 for a more detailed description of the implementation of the proposed New Model

responsible broker-dealer for orders on NYSE's book, and DMM trading activity on the Exchange would be limited to proprietary trading.[15] In addition, during Phase 2, the Exchange will eliminate the order-by-order advance "look" specialists currently receive. Because, with the implementation of Phase 2, they would no longer be specialists, DMMs would not be subject to a specialist's negative obligation not to trade for its own account unless reasonably necessary to the maintenance of a fair and orderly market.[16] The Exchange believes this would give the DMM greater freedom to manage the trading risks associated with their reduced responsibilities to the NYSE market. Like specialists today, DMMs would be able to generate orders through an algorithm that interacts directly with the Display Book. In addition, in the New Model, DMMs would be able to commit additional liquidity in advance to fill incoming orders via the Capital Commitment Schedule or CCS. The CCS is a liquidity schedule setting forth various price points where the DMM is willing to interact with incoming orders.

As part of the redesign of its market, NYSE proposes to amend the rules governing allocation of shares among the participants in a trade with an incoming order.[17] First, NYSE's proposal would amend the Exchange's priority rules relating to displayed interest that establishes the Exchange's best bid or best offer (collectively "Exchange BBO"[18]), most notably by providing such priority interest with the first 15% of any execution and by allowing such interest

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15 The DMM would also be responsible for effecting manual executions in certain circumstances on the Exchange. See infra notes 38-39 and accompanying text.

16 See supra, notes 8-10 and accompanying text. The Exchange has determined to impose certain affirmative obligations on DMMs (including an obligation to provide quotes at the National Best Bid or Offer ("NBBO") a minimum percentage of the trading day).

17 Proposed NYSE Rule 72 (Priority of Bids and Offers and Allocation of Executions).

18 The term "Exchange BBO" refers to the best bid or the best offer on NYSE. It should not be confused with the defined terms "national best bid" and "national best offer" as defined in Rule 600(b)(42) of Regulation NMS Rule 242.600(b)(42) under the Act.

to maintain priority until it is exhausted.[19] Second, in the proposed New Model, all market participants would receive executions on an equal basis ("parity") with other interest available at that price.[20] Similar to the NYSE's current market model, the Exchange would classify each individual Floor broker and the DMM registered in a security as separate market participants, while all off-Floor orders entered in Exchange systems for such security would together constitute a single market participant ("Off-Floor Participant") for the purpose of share allocation. The Exchange's proposed parity rule represents a significant change from its current requirement that specialists yield to all off-Floor orders on the Display Book.

The Exchange also proposes to provide all market participants with the ability to maintain non-displayed "hidden interest"—i.e., reserve interest without a minimum display requirement.[21] Along with the DMM's CCS interest, the Exchange believes this ability of market participants to maintain hidden interest on NYSE's book will contribute to the Exchange's liquidity and depth of market.

2. Updating the Roles of the Various Exchange Market Participants

As indicated above, the New Model proposal includes proposed changes to the roles of the Exchange's various market participant groups to reflect new patterns of trading and new obligations. These include the phasing out of NYSE's specialist system and the adoption of a Designated Market Maker structure. In addition, the Exchange is making changes to the role of, and tools available to, Floor brokers, and is giving new tools to off-Floor participants that will

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19 See infra Section II.B.3.(b) for a more detailed description of the Exchange's proposal regarding priority.

20 See infra Section II.B.3.(b) for a more detailed description of the Exchange's proposal regarding parity.

21 See infra Section II.B.3.(a) for a more detailed description of the Exchange's proposal regarding reserve interest.

enable them to participate in the market more directly. These changes are described in more detail below.

(a) Designated Market Makers

(1) Overview

The Exchange believes that its new market model requires a new type of market maker[22]—the Designated Market Maker—with the ability (and affirmative obligation) to contribute liquidity in a security by trading competitively for its dealer account. The Exchange therefore proposes to phase out the existing specialist system and to replace specialists with Designated Market Makers who would be employees of Designated Market Maker Units ("DMM Units").[23]

As described in further detail below, the Exchange proposes to give DMM Units tools and opportunities that are not available to specialists currently, along with modified obligations, that the Exchange believes are more commensurate with trading in electronic markets. At the same time, the Exchange would preserve several aspects of the specialist system that it believes are beneficial to the market and the investing public.

Current NYSE Rule 104, relating to specialist dealings, will be amended and renamed 104T and will be operative and effective through the end of Phase 1. The Exchange also proposes a new Rule 104 that will be implemented during Phase 2.[24]

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22 The term "market maker" shall have the same meaning as that term in Section (3)(a)(38) of the Act.

23 As of the implementation of Phase 2, pursuant to proposed Rule 104(f)(iv), DMMs will be designated as "market makers" on the Exchange for purposes of the Act.

24 See infra Section II.B.5 for a more detailed description of the phased implementation of the proposed New Model.

(2) DMMs and DMM Units Approved by the Exchange

The Exchange proposes to require that member organizations who want to operate a DMM Unit file an application in writing and be approved by NYSE Regulation prior to operating a DMM Unit. The application and approval requirement would be waived for existing NYSE specialist firms that decide to create a DMM Unit.[25] In deciding whether to approve an application, NYSE Regulation will consider, among other things, the member organization's market making ability, the capital that the member is willing or able to make available for market making and such other factors as NYSE Regulation deems appropriate.[26]

DMMs employed by DMM Units to work on the Floor of the Exchange will be required to be approved and registered with the Exchange. In order to obtain such approval, applicants will need to submit an application to NYSE Regulation, Inc., which will assess an applicant's regulatory fitness, and successfully complete a qualifications examination prescribed by the Exchange.[27]

(3) DMMs Not Responsible Broker-Dealer

The Exchange proposes to amend the provision in Exchange rules that makes specialists the "responsible broker-dealer" for purposes of Limit Order Display and other obligations under both the Act and regulations promulgated thereunder. Under NYSE Rule 60, specialists are currently solely responsible for quoting the highest bids and lowest offers on the Exchange for all reported securities.

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25 See Proposed NYSE Rule 103(b)(ii).

26 See Proposed NYSE Rule 103(b)(i).

27 For a full discussion of the DMM registration and approval process, including provisions for Relief DMMs and Temporary DMMs, see Notice, supra note 5, at 42862.

The Exchange is of the view that this rule is appropriate in a manual trading environment, where the specialist post is the primary locus for trading in securities and where the specialist oversees the reporting of all executions. The Exchange believes this rule makes less sense in an automated market. Market participants who are not specialists post their interest electronically in the form of DOT orders or e-Quotes (broker agency interest files), and Exchange systems process and publish that interest automatically. The Exchange's quote today now includes the Floor broker's agency interest, specialist interest, and electronically entered interest of off-Floor participants, and all interest included in the Exchange's quote is identifiable by the Exchange's systems.

Given the automated processing of participant orders, quotations, and executions, the Exchange believes that the notion that the specialist is the sole responsible broker-dealer is obsolete. And, because various obligations may attach based on whether a participant is designated as the responsible broker-dealer, the Exchange believes that designating the DMM as the "responsible broker-dealer" could place these obligations on a nominal participant while relieving the logically responsible participant of that same obligations. To address these limitations, NYSE is proposing to amend NYSE Rule 60 to reflect that the member or member organization entering a bid or offer in a security is the "responsible broker-dealer" to the extent of such bid or offer.[28]

(4) DMMs' Affirmative Obligation

Although the Exchange does not propose to require DMMs to act as "responsible broker-dealers," the Exchange does propose to impose on each DMM affirmative obligations with

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[28] See 17 CFR §240.602(b)(i).

respect to the quality of the markets in securities assigned to it. The Exchange's proposed Rule 104 sets forth the DMMs' affirmative obligation as follows:

> The function of a member acting as a DMM on the Floor of the Exchange includes the maintenance, in so far as reasonably practicable, of a fair and orderly market on the Exchange in the stocks in which he or she is so acting. The maintenance of a fair and orderly market implies the maintenance of price continuity with reasonable depth, to the extent possible consistent with the ability of participants to use reserve orders, and the minimizing of the effects of temporary disparity between supply and demand. In connection with the maintenance of a fair and orderly market, it is commonly desirable that a member acting as DMM engage to a reasonable degree under existing circumstances in dealings for the DMM's own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated.[29]

In addition, DMM Units would be required to maintain adequate minimum capital[30] based on their registered securities, and would be required to use their capital to engage in a course of dealings for their own accounts to assist in the maintenance, so far as practicable, of a fair and orderly market. Transactions on the Exchange by a DMM for the DMM Unit's account are to be effected in a reasonable and orderly manner in relation to the condition of the general market and the market in the particular stock.[31] To support this requirement, the Exchange would continue to provide depth guidelines[32] for each security, and NYSE Regulation would

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29 See Proposed NYSE Rule 104(f)(ii).

30 The proposed capital requirements for DMMs are identical to the current capital requirements computed for specialists in accordance with Rule 15c3-1 and current NYSE Rule 104. The Exchange proposes to move the placement of these requirements into proposed NYSE Rule 103.

31 See Proposed NYSE Rule 104(g)(i).

32 Currently, the Exchange provides each security with a daily depth guideline and depth sequence size that reflects its individual trading characteristics including intra-day price volatility. Depth sequence sizes over which depth is calculated and the depth guidelines against which the calculated depth movements are compared are dynamically updated each day for each symbol based on the symbol's recent trading characteristics. These characteristics include: its previous NYSE closing price; its NYSE adjusted volume; and

continue to surveil for and enforce DMM compliance with the guidelines.[33]

DMMs would further be required to maintain a bid or offer at the National Best Bid or National Best Offer ("inside") for securities in which the DMM is registered for a certain percentage of the trading day based on the average daily volume of the security. For securities that have a consolidated average daily volume of less than one million shares per calendar month, a DMM Unit must maintain a bid or an offer at the NBBO for at least 10% of the trading day (calculated as an average over the course of a calendar month). For securities that have a consolidated average daily volume of equal to or greater than one million shares per calendar month, a DMM Unit must maintain a bid or an offer at the NBBO for at least 5% or more of the trading day (calculated as an average over the courts of a calendar month). Reserve or other hidden orders entered by the DMM would not be included in the inside quote calculations.[34]

The Exchange further proposes that DMMs retain the re-entry requirements currently imposed on specialists contained in NYSE Rule 104. As such, DMMs effecting Neutral, Non-Conditional and Conditional transactions would still be required to re-enter liquidity on the opposite side of the market depending on the type of transaction executed by the DMM.[35]

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its intra-day consolidated high/low range. Systemic calculations of these values occur each day and are used in the creation of a formulaic individualized depth guideline and depth sequence size that is unique for each security. The Exchange proposes to provide DMMs with the same information pursuant to proposed NYSE Rule 104(f)(iii).

33 Specialist compliance with the depth guidelines is reviewed by the Market Surveillance division of NYSE Regulation on a patterns and practices basis. A specialist's failure to comply with the guidelines may result in referral to NYSE Regulation's Enforcement division for investigation and possible disciplinary action.

34 For a more detailed discussion of how DMM compliance with the quoting requirement is measured and an example of a quoting requirement calculation, see Notice, supra note 5, at 42863-4.

35 Pursuant to proposed NYSE Rule 104(g)(i)(A), DMMs would be subject to the same requirements currently imposed on specialists in current NYSE Rule 104.10(5)-(6). Currently Conditional Transactions operate as a separate pilot; through this filing the

(5) DMMs and Order Information

Once Phase 2 has been implemented, DMMs would not receive an order-by-order advance "look" at incoming orders.[36] The DMM Unit's trading algorithms would have access to information with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest to the extent such information is made publicly available. DMM unit algorithms would receive the same information that is disseminated to the public by the Exchange, at the same time that it is available to other market participants, with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest.[37]

Although the DMM would no longer receive order by order information, there are certain times during which the Exchange believes human interaction is essential to market quality and maintaining a fair and orderly market; specifically, during opening and re-opening transactions, closing transactions, block transactions, gap quote situations, and when trading reaches liquidity replenishment points ("LRPs") that would lock or cross the market.[38] During these specific

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Exchange seeks to incorporate those provisions into the New Model Pilot through proposed NYSE Rule 104(g)(i)(A).

36 In SR-NYSE-2008-67, the Exchange modified the order flow sent to the Specialist Application Programmed Interface, or "SAPI." Commencing with two securities (to ultimately apply to all Exchange securities), the Exchange's systems will send only copies of the following types of orders to the Specialist Algorithm: (i) market orders; (ii) buy limit orders priced at the NYSE bid price or sell limit orders priced at the NYSE offer price; (iii) limit orders priced in between the NYSE bid price and the NYSE offer price; and (iv) limit orders that are priced at or through the opposite side quote (i.e., below the bid in the case of an order to sell or at or above the offer in the case of an order to buy). See Securities Exchange Act Release No. 58628 (July 30, 2008), 73 FR 46122 (August 7, 2008).

37 The Exchange notes that the DMM algorithm would receive "Book State" information, which is the same information that is available to other market participants that subscribe to NYSE market data feeds, and shows aggregated displayed interest at various price points.

38 See Proposed NYSE Rule 104(a)(2)-(5).

situations, DMMs would be responsible for determining the price[39] and effecting executions of orders at that price.

(6) DMMs Would Not Retain the Specialists' Negative Obligation

The Exchange believes that due to the transformation of the equities markets in the United States, the specialists' negative obligation no longer makes sense and should be eliminated. Historically, in a manual, floor-based market, specialists often had a significant informational advantage from being at the center of substantially all of the exchange's activity in a given security. Similarly, in the Hybrid Market, the specialist's advance "look" at incoming orders provided the specialist with a unique and potentially significant informational advantage over other market participants.

Given the real-time availability of market information and resultant increase in market transparency in today's markets and the Exchange's proposed elimination of the advance "look" at incoming orders by the DMM, the Exchange believes that the imposition of a negative obligation on DMMs is unnecessary. Accordingly, the Exchange is proposing that, beginning with the implementation of Phase 2, DMMs would no longer be deemed to be "specialists" or to be subject to the negative obligation.

DMMs, however, would continue to facilitate manual transactions on the Exchange. When DMMs are facilitating manual transactions, Exchange systems would provide DMMs the

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39 In an opening and reopening trade, Display Book would verify that all interest that must be executed in the opening or reopening can be executed at the price chosen by the DMM. If all the interest that must be executed in the transaction cannot be executed at that price, the Display Book would block the execution. In addition, when executing blocks (10,000 shares or more or value of $200,000 or more), trading out of a gap quote situation or an LRP that locks or crossed the market, the Display Book may adjust the execution price if there is enough interest on the Display Book to complete the transaction at a better price.

total volume of all orders eligible to participate[40] in the transaction. All eligible orders would be aggregated by the Exchange system and shown to DMMs as interest available to participate in the manual execution. With this tool, DMMs would have the necessary information to appropriately price opening, re-opening, and closing transactions and to trade out of gap quote and certain LRP situations. DMMs would not have access to such information on an order-by-order basis, as Exchange specialists do today.[41]

(7) DMMs Interest for Quoting and Trading

Although DMMs would no longer be restricted by a negative obligation, DMMs would have an affirmative obligation to contribute to the maintenance of a fair and orderly market by committing capital in order to add liquidity to the market when there is little or no liquidity, and bridge the gaps in supply and demand by trading for their own account. To assist DMMs in meeting these market making responsibilities, DMMs would be permitted to maintain systems that employ algorithms to make trading and quoting decisions ("DMM Interest") on behalf of each DMM.

DMM Interest would be permitted to: (i) supplement the size of the existing Exchange BBO; (ii) maintain displayed and non-displayed DMM Interest, as described more fully below;[42] (iii) layer interest at varying prices outside the Exchange BBO; (iv) partially or completely fill an order at the Exchange BBO or at a sweep price; (v) trade at and through the Exchange BBO;

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40 This information would not include customers' Non-Displayed Reserve Orders and Floor broker agency interest that is designated "Do Not Display." See infra Section II.B.3.(a).(2).

41 Odd-lot orders are a temporary exception to this principle, due to limitations of the Exchange's systems that process odd-lot orders. See infra notes 57-60 and accompanying text.

42 See infra Section II.B.3.(a).

(vi) trade in a sweep transaction; (vii) provide price improvement; and (viii) match better bids and offers published by other market centers where automatic executions are immediately available. Exchange systems would prevent DMM Interest from executing against itself (i.e., executing wash trades).

(8) DMM Capital Commitment Schedule

In addition to DMM Interest, DMMs would be permitted to transmit to the Display Book a Capital Commitment Schedule ("CCS") setting forth additional liquidity that the DMM would be willing to provide at specific price points. The CCS would inform the Display Book of the amount of shares that the DMM is willing to trade at price points outside, at, and inside the Exchange BBO. The CCS is separate and distinct from the DMM Interest. DMM algorithms would send the Exchange this schedule of additional non-displayed trading interest.

CCS interest would be accessed by the Exchange's systems in two ways, depending on whether an incoming order is inside, at, or through the NYSE BBO. When an order is received that would trade at or through the NYSE BBO, the Exchange's system would review all the liquidity available on the Display Book, including CCS interest, and determine the price at which the full size of the order can be satisfied (the "completion price"). When determining the completion price, Exchange systems would take into account all eligible displayed and non-displayed interest available in the Display Book (inside, at, and through the NYSE BBO); any protected bids or offers on markets other than the Exchange ("away interest"); and the DMM's CCS interest at a particular price. Exchange systems would then compare the amount of liquidity required from the DMM's CCS at the completion price with the number of CCS shares offered at the next price that is one minimum price variation ("MPV")[43] or more higher (in the case of an order to sell) or lower (in the case of an order to buy) (the "better price").

If the number of shares that would be allocated to the CCS interest at the better price is greater than the number of shares that would be allocated to the CCS interest at the completion price, then the CCS interest would participate at the better price (with CCS interest yielding to any other interest in Exchange systems at that price). Any remaining balance of the incoming order would be executed at the completion price against displayable and non-displayable interest pursuant to NYSE Rule 72.[44] If the number of shares that would be allocated to the CCS interest at the completion price is equal to or greater than the number of shares that would be allocated to the CCS interest at the better price, the CCS interest will participate at the completion price (with CCS interest yielding to any other interest in Exchange systems at that price).[45]

A DMM's CCS interest inside the Exchange BBO would be accessed by Exchange systems to provide price improvement to incoming orders and to match better-priced bids and offers if available on away market centers. DMMs would not be required to be represented in the bid or the offer in order to provide CCS interest inside the Exchange BBO.

Pursuant to proposed NYSE Rule 1000(e), CCS interest priced inside the Exchange BBO could trade with interest arriving in the Exchange market that: (i) is eligible to trade at or through the Exchange BBO; (ii) is eligible to trade at the price of non-displayable reserve interest

43 Pursuant to NYSE Rule 62, the MPV is currently one cent ($0.01) except that, with respect to equity securities trading on the Exchange at a price of $100,000 or greater, the minimum price variation shall be ten cents ($0.10).

44 A DMM's CCS interest may only participate once in the execution of an incoming order. As such, CCS interest that may exist at the completion price is ineligible to trade with any remaining balance of the incoming order if the DMM's CCS interest was included in the execution of any portion of such order at the better price.

45 For examples of the CCS, see Notice, supra note 5, at 42866-67.

of Reserve Orders and Floor broker agency interest files reserve interest ("hidden interest"); or (iii) is eligible to route to away market interest for execution, if the total volume of CCS interest, d-Quote interest in Floor broker agency interest files, and any other hidden interest would be sufficient to fully execute the incoming order at a price inside the Exchange BBO. The Display Book would determine the price point inside the Exchange BBO at which the maximum volume of CCS interest would trade, taking into account the available d-Quotes and hidden interest. The CCS interest would then participate at that price, on parity with all other interest at that price (i.e., d-Quotes and non-displayed reserve interest). Any reserve interest of the DMM that is also eligible to trade at the price inside the Exchange BBO at which the CCS interest would participate would be aggregated with the DMM's CCS interest at that price when the trade execution is allocated. In this manner, an incoming order may be executed at multiple price points inside the Exchange BBO against d-quotes, non-displayable reserve interest of all participants, and CCS interest. However, CCS interest may only participate once if more than one execution is required to fill the order.

(b) Floor Brokers

(1) Elimination of Percentage Orders

The Exchange proposes to amend NYSE Rule 13 and to delete NYSE Rules 70.25(d)(i)(A), 123A.30 and 1000(d)(2)(D) to eliminate percentage orders. As a result of these proposed amendments, Floor brokers would no longer be permitted to enter CAP-DI orders. In place of this order type, the Exchange intends to provide Floor brokers access to algorithmic technology that would replicate the trading strategy achieved by the use of CAP-DI orders through the Floor broker's handheld electronic device.

The Exchange believes that this change is necessary to improve the efficiency of the Display Book. CAP-DI orders require the system to monitor and calculate many variables, and passively converted CAP-DI orders impede the specialist's ability to function efficiently in an automated market because the specialist must manually complete the passive conversion.[46]

(2) d-Quote Trading with Non-Marketable IOC Orders and at the Open and Close

The Exchange further proposes to amend NYSE Rule 70 to enhance the functionality of the Floor broker d-Quote to increase the liquidity available for executions on the Exchange. Specifically, the Exchange proposes to allow d-Quotes to partially or completely fill a non-marketable immediate or cancel order ("IOC"), which includes NYSE IOC, Reg NMS IOC, and Intermarket Sweep Orders,[47] that are within the d-Quote's discretionary range.[48] In allowing the d-Quote to interact with a non-marketable IOC, the Exchange seeks to provide the IOC an opportunity to receive a partial or complete execution with price improvement. In instances where the d-Quote only partially completes the order, the remaining portion of the non-marketable IOC will be automatically and immediately cancelled.

To further increase the liquidity available at the opening and closing transaction, the Exchange proposes to amend NYSE Rule 70.25(a)(ii) to allow d-Quotes to be active in the opening and closing transactions.

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46 For additional discussion regarding the Exchange's proposed elimination of CAP-DI orders, see Notice, supra note 5, at 42868.

47 See NYSE Rule 13. By their definition, these order types are never quoted but must be automatically executed. Any remaining unfilled portion is immediately and automatically cancelled. Non-marketable IOC orders are immediately and automatically cancelled.

48 See Proposed NYSE Rule 70.25(d)(ix).

(3) Floor Broker Interest Published to OpenBook

The Exchange proposes to have Floor broker interest published in the OpenBook system at every price point (unless designated "Do Not Display" or "DND"). The displayable portions of Floor broker interest that is designated DND will only be published in OpenBook when such interest is at the Exchange BBO. Floor broker agency interest employing Non-Displayed Reserve functionality, as described further below,[49] will not be published in OpenBook.

3. Changes to NYSE Order Types and Order Processing

(a) Additional Undisplayed Liquidity

Floor brokers, off-Floor participants, and DMMs would continue to have the ability to maintain reserve liquidity on the Exchange; however, NYSE proposes to modify each market participant's ability to provide reserve interest. As a threshold matter, the Exchange proposes to amend NYSE Rule 13 to label all undisplayed off-Floor interest "Reserve Orders." Within that category, the Exchange proposes to create two types of reserve interest, "Minimum Display" and "Non-Displayed Reserve."

(1) Minimum Display Orders

Under the proposed rule change, "Minimum Display Orders" require that a minimum of one round lot of the order be designated for display. The Exchange proposes to make permanent NYSE Rule 13 governing Reserve Orders, and also proposes to provide Floor brokers and DMMs with equivalent functionality via a conforming amendment to proposed NYSE Rules 70(e) and 104. Collectively, this minimum display reserve functionality is referred to as "Minimum Display Interest." Each time a Minimum Display Order is replenished from reserve

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49 See infra Section II.B.3.(a).(2).

interest, a new time-stamp is created for the replenished portion of that Minimum Display Order, while the remaining reserve interest retains the time-stamp of its original entry. Minimum Display Interest would be eligible to participate in manual executions, but would not be identifiable to the DMM on an order-by-order basis. Exchange systems would include all Minimum Display Interest in the aggregate order information available for execution at a price point when the DMM facilitates a manual transaction.

The Exchange further proposes that the aggregate of Minimum Display Interest be included in the aggregate interest available to be seen by the DMM in order to provide information about orders available in Exchange systems for response to a Floor broker's market probe request pursuant to NYSE Rule 115. Currently, during a manual execution, Floor broker DND reserve interest that has a displayed quantity and Reserve Orders pursuant to NYSE Rule 13 are included in the aggregated order information displayed to the specialist only during manual executions (e.g., the opening and closing trade on the Exchange, resuming trades after a LRP is reached, or during a gap quote situation). Pursuant to Exchange Rule 70.20(h), access to the Display Book system for information on reserve interest is only for the purpose of effecting transactions that are reasonably imminent.[50] The Exchange proposes to amend NYSE Rules 13, 70.20 and 115 to specifically state that the aggregated Minimum Display Interest will be included in the information disseminated in response to a Floor broker's market probe request pursuant to NYSE Rule 115.

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50 NYSE Rule 70.20(h)(ii) provides, "Specialists, trading assistant and anyone acting on their behalf are prohibited from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction."

Pursuant to NYSE Rule 115(iii) a specialist may provide information about orders contained in the Display Book, referred to also as a market probe, to provide information about buying or selling interest in the market. This information can include aggregated buying or selling interest contained in Floor broker agency interest files other than interest the broker has chosen to exclude from the aggregated buying and selling interest in response to an inquiry from a member conducting a market probe in the normal course of business.

The Exchange further proposes to amend NYSE Rule 70.20(h)(ii) to remove the prohibition against specialist's ability to provide information about Floor broker reserve interest. The Exchange proposes that all Floor broker interest not designated DND be included in the information eligible for dissemination pursuant to NYSE Rule 115.

(2) Non-Displayed Reserve Orders

In addition to Minimum Display Interest, the Exchange further proposes to provide all market participants with the ability to maintain non-displayed interest. This proposed type of reserve interest would not require any of the order to be designated for display and would be available to all market participants. The Exchange proposes to create the "Non-Displayed Reserve Order" for off-Floor participants and provide Floor brokers and DMMs with equivalent functionality. Non-Displayed Reserve Orders of off-Floor customers would not be included in the information available to the DMM for manual execution.

Floor brokers would also be able to utilize non-displayed reserve functionality to enter reserve interest. If the Floor broker uses this functionality, there is no interest displayed in the published quotation, but the interest will be eligible for manual executions because the DMM has the ability to view the Floor broker agency interest in the aggregate. Floor broker agency interest file reserve interest may also be designated as Do Not Display or "DND," meaning such interest will not be available to the DMM for manual executions. As such, Non-Displayed Reserve Orders and Floor broker non-displayed reserve interest that is designated DND would not participate at the open or the close, during a gap quote situation, or when a manual execution is required to trade out of an LRP that locks or crosses the market. Therefore, these types of interest may be executed at an inferior price, and will not be protected in any manual trade – at the choice of the customer. DMM interest employing Non-Displayed Reserve functionality would, however, be eligible to participate in a manual transaction.

Off-Floor participants that want to have non-displayed liquidity participate in a manual transaction would be required to send a Minimum Display Order. Similarly, Floor brokers that choose to have non-displayed liquidity participate in a manual transactions must not designate such interest DND.

(b) Execution of Bids and Offers

The Exchange proposes to amend NYSE Rule 72 to provide to all market participants the ability to receive executions on an equal basis with other interest available at that price. As with NYSE's current parity rules, individual Floor brokers and the DMM registered in the security would each constitute a single market participant, but all orders received by the Display Book directly from off-Floor participants would together constitute a single market participant, the Off-Floor Participant, for the purpose of share allocation. However, unlike specialist interest, which under current NYSE rules must yield to all off-Floor interest residing on the Display Book, DMM Interest would be on parity and would not be required to yield to any off-Floor interest.

(1) Priority and Parity for Setting Interest

Proposed NYSE Rule 72 would modify the concept of priority to provide that, where there is more than one bidder (offerer) participating in an execution and one of the bids (offers) was established as the first at a particular price and such bid or offer is the only interest when such price is or becomes the best bid or offer published by the Exchange (the "Setting Interest"), the displayed portion of such Setting Interest is entitled to priority. In order to qualify as Setting Interest, it must have been the <u>only</u>[51] interest quoted at a price. Only the <u>quoted</u> (<u>i.e.</u>, displayed) portion of the Setting Interest is entitled to priority ("Priority Interest").

Exchange systems would allocate the first 15% of any execution (subject to a minimum of one round lot)[52] at that price to the Priority Interest. For the remainder of that execution, Setting Interest would receive executions on parity with other interest available at that price. Exchange systems would repeat the allocation logic for the Setting Interest until the Priority Interest is completely executed. Any remaining non Priority Interest of the Setting Interest would be executed on parity.

The Exchange proposes to have Priority Interest retain its standing even if the Exchange BBO moves away from the price point. In this case, if the Exchange BBO returns to that price point later in the same trading session, the remaining portion of the Priority Interest would again enjoy priority until it is executed or cancelled, trading in the stock is halted, the trading session ends, or the BBO moves away again.

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51 If, at the time of quoting, Non-Displayed Reserve Orders, Floor broker interest or DMM interest employing Non-Displayed Reserve Functionality exist at the price point along with a single order or quote that has a published quantity, the single order would be deemed to be a setting order even if the Hidden Reserve Orders and Floor broker and DMM interest employing Hidden Reserve Functionality arrived first. In addition, if prior to quoting, there are two orders at the price point and one of those orders cancels, the remaining order that is the only interest quoted at the price would be considered the Setting Interest. <u>See</u> Proposed Rule 72(a)(ii).

52 All allocations will be done on a round lot basis. If 15% would result in the Priority Interest receiving a mixed lot, Exchange systems will round up to the nearest round lot.

Partial cancellations would count first against the non-Priority Interest of any Setting Interest. All allocations to the Setting Interest would be decremented from the Priority Interest first whether the allocation is based on priority or parity. Setting Interest may be executed on parity with no priority allocation if the quote moves to a better price point and thereafter an incoming order exceeds the shares available for execution at the newly established Exchange BBO. In those instances, the Setting Interest will be executed on parity and the Priority Interest will be decremented first.

(2) Priority and Parity in the Absence of Setting Interest

Where there is no Setting Interest, Exchange systems would divide the size of the executing order by the number of participants. The total number of shares to be allocated to each participant (i.e., the single Off-Floor Participant, the DMM, and each Floor broker) would be distributed equally among the market participants, subject to the need to allocate in round lots. Within the single Off-Floor Participant, shares executed would be allocated in order of time priority of receipt of orders from off-Floor customers into Exchange systems. Executions would be allocated in round lots. In the event the number of shares to be executed at the price point is insufficient to allocate round lots to all the participants eligible to receive an execution at the price point, the Exchange systems would create an allocation wheel of the eligible participants at the price point and the available shares would be distributed to the participants in turn.

On each trading day, the allocation wheel for each security would be set to begin with the participant whose interest is entered or retained first on a time basis. Thereafter, participants would be added to the wheel as their interest joins existing interest at a particular price point. If a participant cancels its interest and then rejoins, that participant would join as the last position on the wheel at that time.

Non-displayed interest at price points within the Exchange BBO would also trade on parity at each price point. Thus, non-displayed interest that is priced within the Exchange BBO would be eligible to be executed on parity at each price point against incoming orders.

The Exchange further proposes to modify its overall allocation logic to require that, for all executions at or through the Exchange BBO, displayable interest trades ahead of non-displayable interest available for execution at the same price point. Once all displayable interest has been satisfied at a given price point, the remainder of the incoming order would execute against non-displayable interest at that price point. All categories of non-displayable interest would trade on parity, with the exception of the DMM's CCS interest, which yields to all other interest at the same price.

4. Additional Proposed Rule Changes

In addition to the proposed rule changes discussed above, the Exchange has proposed numerous minor substantive changes and conforming changes throughout the Exchange's rule book in order to conform NYSE's rules to the proposed New Model.[53]

5. Implementation Schedule

The proposed amendments herein require the Exchange to make significant modifications to Exchange systems. The Exchange therefore proposes that the proposed rule change be implemented in stages pursuant to the schedule outlined below.

(a) Non-Pilot Rules

The Exchange proposes that the amendments to NYSE Rule 13 regarding the establishment of Reserve Order types and the elimination of CAP orders would be implemented upon Commission approval as permanent changes to the NYSE rulebook. Similarly, all conforming changes to other Exchange rules to enable Floor brokers and DMMs to use equivalent reserve order functionality would be implemented upon Commission approval as permanent changes to the NYSE rulebook. In addition, the Exchange proposes that amendments to NYSE Rules 2 and 103 establishing the DMMs and DMM units also would be implemented upon Commission approval as permanent changes to the NYSE rulebook.

The Exchange further proposes that the proposed amendments to NYSE Rule 70 that: (i) allow for the publication of Floor broker interest to OpenBook; (ii) allow d-Quote instructions to be active during the open and close; and (iii) allow d-Quotes to trade with non-marketable IOC orders would be implemented upon Commission approval as a permanent change to the NYSE rulebook.

(b) Pilot Rules

The Exchange further proposes to implement certain provisions of the New Model proposal on a pilot basis ("New Model Pilot") upon Commission approval of the proposed rule change. The New Model Pilot would operate until October 1, 2009.

During Phase 1 of the New Model Pilot, the Exchange would implement proposed NYSE Rule 72 and proposed NYSE Rule 104T.[54] During the operation of Phase 1, pursuant to proposed Rule 72, all market participants, including DMMs, would have the ability to receive executions on parity with other interest available at that price. In addition, during Phase 1, DMMs would still receive the order-by-order "look" that the specialists currently receive.

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53 For a full discussion of these additional proposed rule changes, see the Notice, supra note 5, at 42870-1.

54 Proposed NYSE Rule 104T is a temporary rule that would operate through the end of Phase 1 and cease operation with the implementation of Phase 2.

During this period, DMMs would still be considered "specialists" under the Act, subject to applicable affirmative and negative obligations.

With the implementation of Phase 2, NYSE Rule 104T would cease operation and new NYSE Rule 104 would supersede it. Beginning in Phase 2, the DMM would no longer receive any order-by-order information. In addition, under proposed Rule 104, DMMs would no longer be subject to a negative obligation. Also as of that date, the portion of Rule 1000 relating to the DMM's CCS interest would be implemented.

During the operation of the New Model Pilot, the Exchange has committed to provide the Commission's Division of Trading and Markets and Office of Economic Analysis with statistics related to market quality, trading activity, and sample statistics as requested by the Commission.

C. Amendment No. 2

In Amendment No. 2 to the proposed rule change, the Exchange proposes to: (i) clarify how odd-lot information will be transmitted to the DMM Unit algorithm prior to the opening; (ii) retain and expand the restriction, currently applicable to specialists, trading assistants, and anyone acting on their behalf from accessing certain Exchange systems and apply it to DMMs, trading assistants, and anyone acting on their behalf; (iii) make technical amendments to NYSE Rules 13, 52, 72, 299A, and 1000; (iv) reconcile the rule language of NYSE Rules 98, 98A, 99, 104T, 105, 113 and 460 with amendments approved by the Commission pursuant to filing SR-NYSE-2008-45 ("2008-45 Amendments")[55]; (v) reconcile the rule language of NYSE Rule 104T with the NYSE's immediate effectiveness filing SR-NYSE-2008-73 ("2008-73 Amendments")[56];

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55 See Securities Exchange Act Release No. 58328 (August 7, 2008), 73 FR 48260 (August 18, 2008) (SR-NYSE-2008-45).

56 See Securities Exchange Act Release No. 58351 (August 13, 2008), 73 FR 48416 (August 19, 2008) (SR-NYSE-2008-73).

and (vi) describe the data that the Exchange will provide the Commission to monitor the New Model Pilot.

Specifically, Amendment No. 2 proposes to clarify that, while the individual DMM would have access only to aggregate order information as it pertains to round-lot and odd-lot orders, the DMM Unit algorithm would receive odd-lot information on an order-by-order basis prior to the opening. Odd-lot orders on the Exchange are processed in a separate system from the Exchange systems that execute round-lot orders. Odd-lots are executed systemically by Exchange systems designated solely for odd-lot orders (the "odd-lot System").[57] The odd-lot System executes all odd-lot orders against the specialist[58] as the contra party. In order for the DMM Unit algorithm to effectively facilitate an opening transaction, the DMM Unit algorithm would also be provided odd-lot information prior to the opening. Constraints inherent in the odd-lot System require that odd-lot information be transmitted to the DMM Unit algorithm on an order-by-order basis prior to the opening.[59] As such, prior to the opening, Exchange systems will transmit to the DMM Unit algorithm odd-lot order information excluding e-Quote odd-lots, odd-lot cancellations, Stop odd-lot orders and Good 'til Cancel odd-lot orders.[60] Once the security is opened, Exchange systems would not provide any order-by-order odd-lot information to the DMM Unit algorithm.

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57 See NYSE Rule 124(a).

58 Odd-lot orders will continue to be executed against the DMM as the contra. See proposed NYSE Rules 104(e) and 124(a).

59 The Exchange is currently working on modifications to its odd-lot system that would allow for the transmission of aggregate odd-lot information to DMM unit algorithms in the third quarter of 2009 so that order-by-order transmission would no longer be required.

60 See proposed NYSE Rule 104 Supplementary Material .05.

In addition, Amendment No. 2 proposes to clarify that the Exchange seeks to retain and expand the restriction, currently applicable to specialists, trading assistants, and anyone acting on their behalf from accessing certain Exchange systems other than for the purpose of effecting transactions that are reasonably imminent, and apply it to DMMs, trading assistants, and anyone acting on their behalf.[61] In addition, the Exchange seeks to add information pertaining to Minimum Display Reserve Orders to the restriction and move the restriction from NYSE Rule 70 to the rules governing DMM requirements.[62] The proposed rule would prohibit DMMs, trading assistants, and anyone acting on their behalf from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest and Minimum Display Reserve Order information other than for the purpose of effecting transactions that are reasonably imminent, and where such Floor broker agency and Minimum Display Reserve Order interest information is necessary to effect such transaction.

Amendment No. 2 also proposes technical corrections to the rule text. Specifically, the Exchange proposes to change the word "specialist" to "DMM" in NYSE Rule 13 because during the editing process the word specialist was inadvertently left in this rule. The Exchange further amended their proposal to remove previously proposed changes to NYSE Rule 52 that the Exchange instead intends to be the subject of a separate future filing. Also, rule language designating proposed Rule 72 as operating in the New Model Pilot was inadvertently not

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61 Specifically, NYSE Rule 70.20(h)(ii) provides in pertinent part that: "Specialists, trading assistants and anyone acting on their behalf are prohibited from using the Display Book® system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction."

62 See proposed NYSE Rules 104T(j) and 104(a)(6).

underscored. The Exchange proposes to add the required underscoring to designate that text as new language pursuant to this filing. In addition, Amendment 2 reflects the Exchange's proposal to delete subparagraph (b)(2) of the Supplemental Material .10 of NYSE Rule 299A because, similarly to specialists under the current NYSE market model, DMMs will not be allowed to "stop" stock. Further, in order to correct lettering errors in NYSE Rule 1000, the Exchange proposes to move the language denoting the Rule as operating in the New Model Pilot to directly after the name of the rule and retain the original lettering.

On August 7, 2008, the Commission approved the 2008-45 Amendments which, among other things, modified the rule text of NYSE Rules 98, 98A, 99, 104T, 105, 113 and 460. Through Amendment No. 2, the Exchange seeks to change the term "specialist" to DMM in NYSE Rules 98 and 98A to reflect the new language approved in the 2008-45 Amendments.

In addition, on August 13, 2008, the Exchange filed with the Commission for immediate effectiveness a proposal to amend NYSE Rule 104(b) to provide for an automated opening message that is effectuated through the specialist Application Programmed Interface to allow specialists to automatically open a security on a transaction. Through Amendment No. 2, the Exchange proposes to amend Rule 104T(b)(ii) to incorporate the rule language from the 2008-73 Amendments.

Finally, during the operation of the New Model Pilot, the Exchange is committed to providing the Commission's Division of Trading and Markets and the Office of Economic Analysis with statistics related to market quality, trading activity, and sample statistics. The metrics discussed below, along with any other metrics the Exchange may choose to provide, will be transmitted to the Commission on a monthly basis. The Exchange will maintain average measures for each trading day during a particular month[63] in order to provide such information to the Commission upon request.

On or before the 20th day of the second calendar month following the Approval Date,[64] the Exchange will provide the Commission with the data described below, which will include data for all the trades in the two months prior to the commencement of the New Model Pilot. The data to be provided on such date will include the following:

1. The specialist time at the NBBO by security.
2. The effective spread by security.
3. The specialist volume broken out by "specialist interest type" (e.g., s-Quote and s-Quote employing reserve functionality). The Exchange will further provide the total shares traded expressed in twice total volume ("TTV") where both the buy and sell shares are counted for each trade to allow the Commission to track the direction of the overall specialist participation rate over time.
4. The average depth at the NBBO for specialists.

On the 20th day of the month following the initial provision of data, the Exchange will provide the Commission with the data described below, which will include data for all the trade dates in the months directly following the Approval Date through the last trade date of the previous month. On the same date, the Exchange will additionally provide data related to the average depth at the NBBO for Floor brokers and orders represented in the Display Book for the

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[63] The average per security may be provided across volume deciles.

[64] The timing of the provision of the market quality, trading activity, and other statistics to the Commission was set forth in Amendment No. 3.

two months prior to the commencement of the New Model Pilot.[65] Thereafter the Exchange will provide the data described below on the 20th day[66] of each calendar month until the end of the New Model Pilot. The data will reflect the trading activity of the prior calendar month. The specific data to be provided until the end of the New Model Pilot is as follows:

1. The DMM time at the NBBO by security.
2. The effective spread by security.
3. The DMM volume broken out by "DMM interest type" (e.g., CCS, s-Quote). The Exchange will further provide the total shares traded expressed in TTV where both the buy and sell shares are counted for each trade to allow the Commission to track the direction of the overall DMM participation rate over time.
4. The average depth at the NBBO by market participant (DMMs, Floor brokers, and orders represented in the Display Book).
5. The ratio of (i) shares not executed on the Display Book due to DMM execution to (ii) the shares executed by the DMM.
6. Effective spread for: (a) orders that involve DMM liquidity provision and (b) orders that are executed without DMM liquidity (for similar order size categories).

D. Amendment No. 3

In Amendment No. 3 to the proposed rule change, the Exchange proposes to: (i) modify the dates that the Exchange is required to provide data to the Commission; (ii) amend the operative dates of certain rules; (iii) clarify the implementation schedule of the New Model Pilot;

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65 The Exchange represents that it is unable to provide this data in the requested format prior to this date.

66 In the event the 20th day of the calendar month is a non-business day, the Exchange would provide the data on the next business day following the 20th day of that month.

and (iv) make technical amendments to NYSE Rules 98 and 98 Former (e.g., changing the term "specialty stocks" to "registered security").

In Amendment No. 3, the Exchange clarified that the implementation of the New Model Pilot would occur in two phases, Phase 1 and Phase 2. Each phase of the New Model Pilot would commence initially in three or four securities. The Exchange proposes that after a period of monitoring the system operation, NYSE would progressively implement each phase of the New Model Pilot in additional securities until that phase is operative in all securities traded on the Floor. The rules applicable to each phase of the New Model Pilot would apply to trading in securities as they are added to each phase. Implementation of Phase 1 will be completed no later than five weeks after the Approval Date, and implementation of Phase 2 will be completed no later than ten weeks after the Approval Date.

III. Discussion and Commission Findings

After careful review, we find that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, we find that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act[67] which requires, among other things, an exchange to have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[68] The Commission

[67] 15 U.S.C. 78f(b)(5).

[68] In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act,[69] which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

A. Redefinition of the Role of the Specialist; Designated Market Makers

One major element of NYSE's New Model is the elimination of specialists and the introduction of Designated Market Makers. DMMs would be assigned affirmative obligations, some of which are similar to those currently imposed on specialists. Specifically, DMMs would have an obligation to use the firm's own capital to contribute to the maintenance of a fair and orderly market on the Exchange in its assigned securities, would be subject to depth guidelines,[70] and would have an obligation to maintain a bid or an offer at the National Best Bid or National Best Offer for a certain percentage of the trading day.[71] In addition, DMMs would be required to facilitate transactions in their assigned securities during certain specified periods, namely for opening and re-opening transactions, closing transactions, block transactions, gap quote situations and when trading reaches LRPs that would lock or cross the market. DMMs would be responsible for choosing the price and for the executions of the orders at that price during those specific situations. The Exchange has also proposed to eliminate for DMMs the advance "look"

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69 15 U.S.C. 78f(b)(8).

70 For more information regarding depth guidelines, see Notice, supra note 5, at 42863, n. 115.

71 For securities that have a consolidated average daily volume of less than one million shares per calendar month, a DMM Unit would be required to maintain a bid or an offer at the NBBO for at least 10% of the trading day (calculated as an average over the course of a calendar month). For securities that have a consolidated average daily volume of equal to or greater than one million shares per calendar month, a DMM Unit would be required to maintain a bid or an offer at the NBBO for at least 5% or more of the trading day (calculated as an average over the course of a calendar month). See supra note 34 and accompanying discussion.

equitable principles of trade and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[76] Likewise, Section 11A of the Act emphasizes that the national market system should promote the public interest, the protection of investors, and the maintenance of fair and orderly markets.[77] In considering the proposed rules of a national securities exchange, we must therefore take into account their effect not only on the participants of the given market, but their impact on investors and the public interest generally.

We recognize that the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading, and that an exchange may legitimately confer benefits on market participants willing to accept substantial responsibilities to contribute to market quality.[78] However, while the rules of an exchange may confer special or unique benefits to certain types of participants, they must ensure, among other things, that investors and the public interest are protected.[79]

We carefully review trading rule proposals that seek to offer special advantages to market makers. Although an exchange may reward such participants for the benefits they provide to the exchange's market, such rewards must not be disproportionate to the services provided.[80] In considering NYSE's New Model provisions relating to DMMs, we have assessed whether the rewards granted to DMMs—including granting DMMs parity with respect to orders from off-

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76 Id.

77 15 U.S.C. 78k-1(a)(2).

78 See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) at 40148.

79 15 U.S.C. 78f(b)(5).

80 See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008) at 40148 ("Market makers can play an important role in providing liquidity to the market, and an exchange can appropriately reward them for that as well as the services

Floor participants and giving DMMs unique hidden interest functionality via the proposed CCS—are commensurate with their obligations under the New Model.

Under NYSE's current market model, specialists are designated as the "responsible broker-dealer" for orders resting on the Display Book. NYSE specialists, by virtue of their advance "look" at incoming orders and their position on the trading floor, also have an informational advantage over other market participants which, if unchecked, could permit them to adjust their trading interest to the disadvantage of orders residing on the book. Because of this, specialists are required to yield to all off-Floor participant orders on Display Book and are subject to the negative obligation not to trade for their own account in any security in which the specialist is registered "unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."[81]

In support of its proposal to eliminate the negative obligation and allow the specialists' successors, DMMs, to trade on parity with public customer orders, NYSE argues that the negative obligation is "an outmoded vestige of trading in a wholly different market environment and is unnecessary."[82] The Exchange believes that advances in technology, including electronic trading and the availability of real-time market information, make it difficult, if not impossible, for any single market participant, including a specialist, to have a time-and-place advantage over other market participants. In addition, the Exchange believes that the fragmentation of liquidity in the marketplace has lessened the importance of the specialist's influence over its registered securities. Moreover, NYSE proposes to eliminate for DMMs, during Phase 2 of the

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they provide to the exchange's market, so long as the rewards are not disproportionate to the services provided.") (citation omitted).

81 See current Rule 104(a).

82 See Notice, supra note 5, at 42865.

implementation, the advance "look" at incoming orders that specialists currently receive under the Exchange's current rules.

We generally agree that, given the widespread adoption of electronic, automated trading, the ability of market participants to avail themselves of robust real-time market information, and the reduction in NYSE's market share in recent years, the historic time-and-place advantage of specialists has been reduced in today's market environment, though we do not believe that such advantage has been completely eliminated.[83] The Exchange has proposed to fully eliminate the advance "look" specialists currently receive during Phase 2 of the implementation. In doing so, the Exchange has represented that, other than for odd-lot orders,[84] a DMM Unit's algorithm would receive the same information with respect to orders entered on the Exchange, Floor broker agency interest files, or reserve interest as is disseminated to the public by the Exchange, and would receive such information no sooner than it is available to other market participants.

We believe that the proposed elimination of the specialist's "look"—when viewed in conjunction with the obligations imposed upon DMMs, including a general affirmative obligation on the DMM to use its capital to contribute to the maintenance of a fair and orderly market in its assigned securities; an obligation to quote at the National Best Bid or National Best Offer for a certain percentage of time; an obligation to facilitate transactions during specified

83 The Commission notes that, while NYSE's overall market share in NYSE-listed securities has fallen dramatically in recent years, it continues to execute a higher percentage of the volume in certain of these securities than any other single exchange. In addition, while the move to largely electronic trading has substantially reduced the information advantage gained from a presence on the Exchange Floor, DMMs retain some informational advantage to the extent there continue to be manual negotiations and executions on the Floor.

84 See supra Part II.C.

periods; and depth guidelines[85]—reflects an appropriate balance of DMM obligations against the benefits provided to DMMs under this proposal, including providing DMMs parity with other market participants (and preferential allocations to the extent there are multiple orders of off-Floor participants in the Display Book at the execution price) and providing DMMs unique functionality through the CCS. However, given the significant advantage DMMs would receive by being on parity with market participants (discussed below in Part III.B), we are seeking further evidence that the benefits proposed for DMMs are not disproportionate to their obligations.[86]

In addition, while we believe that the proposed operation of the DMM's unique CCS functionality is designed to provide a slightly better execution price for a portion of a large incoming order because that portion of the order could receive an execution price of a penny better than it would have received absent the CCS interest, we note that the CCS would provide DMMs the opportunity to obtain its CCS execution at an advantageous price with minimal risk, and with no contribution to the visible depth of the market.

85 The Commission notes that the proposed obligations of DMMs would also differ significantly from those imposed on specialists currently on the Exchange in that DMMs would no longer be the "responsible broker-dealer" for orders resting on Display Book and the specialists' negative obligation would be eliminated. We note that the DMM's duties in connection with order executions on Hybrid are substantially reduced under the proposed rules. Whereas Rule 60 currently requires the specialist, as "responsible broker-dealer," to collect, process, and publish quotations, in fact in the current automated market, virtually all orders submitted to the Display Book are processed, published, and executed automatically, with no handling by the specialist. Given the substantially reduced duties of the DMM in connection with order executions, the Commission believes it is appropriate for the Exchange to no longer consider the DMM to be the "responsible broker-dealer" for orders on the Display Book, and instead consider the broker-dealer that submitted the order to the Exchange to be in such position.

86 For a description of the metrics the Exchange has agreed to provide, see supra Part II.C.

Accordingly, we are approving the proposal's provisions with regard to the elimination of specialists and the creation of DMMs, but we are approving certain key provisions on a pilot basis until October 1, 2009, as discussed more fully below in Part III.D.

B. Order Allocation

NYSE proposes to revise the order allocation methodology of Rule 72 to provide that: (i) all market participants would receive executions on parity; (ii) "Setting Interest" that establishes the Exchange BBO would be entitled to priority and would receive the first 15% of any incoming order (subject to a minimum of one round lot) in advance of the regular allocation of such order; and (iii) for executions occurring outside the Exchange BBO, all displayable interest would be executed before any non-displayable interest.

One of the most significant changes in the Exchange's proposal is the elimination of the requirement currently imposed upon specialists to yield to off-Floor participant orders on the Display Book. Once the specialist's advance "look" at incoming orders is fully eliminated, and DMMs are no longer subject to the specialist's agency responsibilities with respect to orders on Display Book, we agree that it would no longer be necessary to require DMMs to yield to off-Floor participant orders on the Display Book. However, the Exchange's proposal does not merely eliminate the requirement to yield to off-Floor participants, but rather provides DMMs with a substantial advantage over off-Floor orders sent to the Display Book. As the Exchange stated in its proposal, it is amending its Rule 72 "to provide to all market participants the ability to receive executions on an equal basis ('parity') with other interest available at that price."[87] The Exchange's concept of parity hinges on its definition of "market participant." According to the Exchange's definition, the DMM registered in a given security and each individual Floor

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87 See Notice, supra note 5, at 42869.

broker representing orders in such a security would each constitute a single market participant. In contrast to the Exchange's DMM and Floor brokers, all off-Floor orders would be aggregated together to constitute a single market participant, the Off-Floor Participant.[88] Because of the aggregated nature of the Off-Floor Participant, in many cases a DMM's interest would be assured of receiving some execution while the Off-Floor Participant, even if composed of multiple Display Book orders and even if such orders constituted a large volume of shares, would receive an allocation equal to that received by the DMM. Particularly in instances when there is more than one off-Floor order resting in the Display Book at a particular price point at the time of execution, the result would likely be that some orders in the Display Book would remain unexecuted, despite potentially having been entered into the Display Book prior to the DMM's interest having been submitted.

In addition, NYSE's proposal would permit an interim period—from the approval of the this proposed rule change through completion of Phase 2—when DMMs would have parity with other market participants (i.e., including off-Floor orders) while retaining the current specialists' advance "look."[89] This period, albeit short, would provide DMMs with a significant informational advantage over other market participants, while also providing them parity in executing their interest.

For these reasons, we are concerned about the effects the proposed parity rule may have on market quality, book depth, and the execution rates of public customer orders posted to

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88 See id.; see also proposed Rule 72(c)(ii).

89 The Exchange will eliminate the "look" for a particular security upon implementation of Phase 2 for such security. Amendment No. 3 to the proposed rule change establishes a deadline of ten weeks after the Approval Date for completion of Phase 2. Any extension of this deadline would require NYSE to file a proposed rule change under Section 19(b) of the Exchange Act for Commission review.

Display Book. Therefore, we have determined to approve proposed Rule 72 on a pilot basis, as discussed more fully below in Part III.D.

With respect to the priority provisions for Setting Interest under proposed Rule 72(a), in addition to the proposed 15% priority allocation, the Setting Interest would also participate on parity with other market participants (as it would even if it were not the Setting Interest) in the allocation of the remaining 85% of an incoming order.[90] Moreover, the Setting Interest maintains its priority status until the interest is completely executed. Thus, proposed Rule 72(a) is designed to reward aggressive quoting by market participants—which contributes to market quality—by allowing the price setter to take the first portion of an execution at that price. We believe that the proposed priority rule constitutes an appropriate approach, consistent with the Act, for incentivizing and rewarding market participants who quote aggressively to set the Exchange BBO.

Finally, we believe that the proposed provisions designed to ensure that all displayable interest trades ahead of any non-displayable interest for executions occurring outside the Exchange BBO are consistent with the Act. Currently, NYSE rules are designed to ensure that all displayed interest at the Exchange BBO is fully executed prior to any execution of undisplayed interest at the Exchange BBO. We believe that these proposed amendments to Rule 72, which are designed to ensure that the same requirement is applied to executions outside the

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90 The Commission also notes that there is a requirement that the Setting Interest receive a minimum of one round lot, typically 100 shares. See proposed NYSE Rule 72(c)(iii). Given the reduction in average execution sizes on the Exchange recently, the Commission notes that the Setting Interest would likely often receive more than 15% because of the round lot minimum requirement. See, e.g., Securities Exchange Act Release No. 56599 (October 2, 2007), 72 FR 57622 (October 10, 2007) (SR-NYSE-2007-93) at fn. 6 (noting that average execution size had declined from 334 shares in November 2006 to 254 shares in August 2007).

Exchange BBO, are consistent with the Act, since preferencing interest that is displayed or designated for display over hidden interest should contribute to price discovery, and thus is consistent with the requirements of Section 6(b)(5) of the Act that exchange rules be designed to perfect the mechanism of a free and open market and the national market system and not be unfairly discriminatory.

C. Reserve Order Functionality

In April 2008, the Exchange implemented a pilot program that provides reserve order functionality for orders with a minimum display quantity of one round lot, now proposed to be called Minimum Display Reserve Orders, to off-Floor market participants.[91] Minimum Display Reserve Orders give off-Floor participants a reserve functionality substantially similar to the reserve functionality of Floor brokers' d-Quote and specialists' s-Quotes. The Exchange now proposes to make this pilot program permanent. In addition, the Exchange proposes to create hidden interest functionality (i.e., with no minimum display requirement), known as Non-Displayed Reserve Orders, for off-Floor participants. This functionality would also be available to Floor brokers and DMMs.

We believe that extending the hidden interest functionality of Minimum Display and Non-Displayed Reserve Orders to all market participants would help level the playing field among NYSE members on and off the Floor, and is consistent with the Section 6(b)(5) of the Act, because it is designed to promote just and equitable principles of trade among Exchange customers and members and is not unfairly discriminatory. In addition, we agree that these additional order types, by expanding the opportunities for market participants to post different

91 See Securities Exchange Act Release No. 57688 (April 18, 2008), 73 FR 22194 (April 24, 2008) (SR-NYSE-2008-30).

types of liquidity on the exchange, should result in deeper liquidity and thus may contribute to overall market quality. We note that the rules of other national securities exchanges also provide for similar order functionality.[92]

However, the Exchange's proposed treatment of hidden interest is not identical among market participants, particularly with respect to manual executions.[93] While all Minimum Display interest is included in the manual execution template, the same is not true of hidden interest. A DMM's hidden interest would be eligible to participate in manual transactions since this interest would always be known to the DMM. In contrast, Non-Displayed Reserve Orders of off-Floor participants, which would be fully hidden from the DMM, would never be eligible for participation in manual transactions. Finally, Floor brokers' hidden interest would be included in the manual execution template and eligible to participate in manual transactions unless the Floor broker, at his or her option, marked the order "Do Not Display."[94]

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92 See NYSE Rule 13. See also, e.g., Nasdaq Rules 4756(c)(3) and 4757; NYSE Arca Equities Rule 7.31(h)(3); and ISE Rule 715(g)(1).

93 In the New Model, DMMs would continue to facilitate manual transactions on the Exchange in a limited number of situations. See supra, Part III.A. Orders eligible for manual execution are aggregated by Exchange systems and shown to the DMM in the Display Book's manual execution template.

94 In Amendment No. 2, the Exchange proposed to prohibit DMMs, their trading assistants, and others acting on their behalf from using Display Book to access information about Floor broker agency interest excluded from the aggregated agency interest and Minimum Display Reserve Order information other than for the purpose of effecting transactions that are reasonably imminent where such information is necessary to effect the transaction. Because this restriction is designed to prevent DMMs from gleaning an informational advantage from access to ordinarily hidden information on the Display Book that is not necessary to the performance of their obligations, we find that the retention and expansion of this provision is consistent with the Act, including Section 6(b)(5) thereunder, which requires that proposed rules promote just and equitable principles of trade, and not be designed to permit unfair discrimination between customers, issuers, brokers, and dealers.

Though these functionality differences exist in the proposed implementation of hidden interest among different market participants, we note that all participants have the ability to ensure that their interest participates in manual transactions if they so choose. Floor brokers could do so by not designating their hidden interest as "Do Not Display," while off-Floor participants could instead send their interest to the Exchange as a Minimum Display Reserve Order, which requires the display of one round lot and is eligible to participate in its entirety in manual transactions. Accordingly, we believe that NYSE's proposed rules regarding reserve functionality are not unfairly discriminatory and otherwise are consistent with the Act.

D. New Model Pilot Program

As discussed in Part II.B.5.(b) above, several key provisions of the Exchange's New Model proposal are being approved today on a pilot basis (collectively, the "Pilot provisions"). The New Model Pilot will include: (i) the changes to NYSE's priority and order allocation structure under proposed Rule 72; (ii) the dealings and responsibilities of DMMs, including the affirmative obligation to market quality, the quoting obligation, the re-entry requirements following certain transactions for the DMM's own account, and, implicitly, the elimination of the negative obligation, set forth in proposed Rule 104; and (iii) the provisions related to DMM CCS interest set forth in proposed Rule 1000.

As discussed above, we have concerns regarding certain aspects of the Exchange's proposal and are therefore approving the provisions described above on a pilot basis for a period ending October 1, 2009. Before we decide what action to take on any NYSE proposal to extend the operation of the Pilot provisions or to establish the Pilot provisions on a permanent basis, we believe that NYSE must provide data and analysis on the impact of the Pilot provisions.

Specifically, we believe that to be able to take any further action on an NYSE proposal with regard to the Pilot, NYSE must provide to us on a regular, ongoing basis, statistics relating to market quality and trading activity.[95] The Exchange has committed to providing us with these metrics on a monthly basis. The Exchange has also represented that it will maintain average measures for each trading day during a particular month in order to provide such information to us upon request.[96] Analysis of the requested statistics will assist the Commission, among other things, in evaluating the effects of the Pilot provisions on NYSE's market quality, and in determining whether the New Model Pilot should be permanently approved, if so requested by the Exchange, with or without adjustments, consistent with the Act.

The Commission intends to closely examine these statistics and other information relating to the impact of the Pilot provisions on investors and other market participants. If the Commission determines, upon expiration of the Pilot period or at any earlier time, that implementation of the New Model Pilot is having a detrimental effect on investors or other market participants, the Commission will consider what action it should take to address any detrimental effect.

E. Other Proposed Changes

Several of NYSE's proposed changes, such as the approval procedures for DMMs and DMM Units, elimination of Floor broker percentage orders, changes to the handling of Floor broker d-Quotes, and inclusion of additional Floor broker interest in OpenBook, raise policy issues that we have considered previously, and resolve such policy issues in a manner consistent with our prior approvals. The remainder of NYSE's proposed changes are technical, non-

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95 For a description of the metrics the Exchange has agreed to provide, see supra Part II.C.

96 The average per security may be provided across volume deciles.

the necessary technical changes to its system that will obviate the need for the sending of order-by-order odd-lot information to the DMM Unit algorithm.

In Amendment No. 2, the Exchange has also proposed to retain the restriction currently applicable to specialists prohibiting them, their trading assistants, and others acting on their behalf from using the Display Book system to access information about Floor broker agency interest excluded from the aggregated agency interest other than for the purpose of effecting transactions that are reasonably imminent where such Floor broker agency interest information is necessary to effect such transaction. The Exchange's proposal would apply this restriction to DMMs and include information pertaining to Minimum Display Reserve Orders within the restriction. Because this restriction is designed to prevent DMMs from gleaning an informational advantage from their access to ordinarily hidden information on the Display Book that is not necessary to the performance of their obligations, we find that the retention and expansion of this provision is consistent with the Act, including Section 6(b)(5) thereunder, which requires that proposed rules promote just and equitable principles of trade, and not be designed to permit unfair discrimination between customers, issuers, brokers, and dealers.

In this amendment, the Exchange has made minor edits to its rule text (in particular, in NYSE Rules 13, 52, 72, 299A and 1000) that are technical or clarifying in nature. Finally, in Amendment No. 2, the Exchange has committed to provide us with specific metrics on an ongoing basis that relate to market quality and certain of its rules that are subject to the New Model Pilot. We believe that this data will be important in helping the Commission analyze the impact of the New Model Pilot, and in determining whether to permanently approve or modify it, if so requested by the Exchange. Therefore, we find that these proposed changes are consistent with the Act.

In Amendment No. 3, the Exchange modified the dates that the Exchange is required to provide data to the Commission, amended the implementation dates of certain rules, and clarified the implementation schedule of the New Model Pilot. Finally, in Amendment No. 3, the Exchange proposed technical changes to Rule 98 and 98 Former to replace the term "specialty stocks" with "registered security."

The Exchange has requested that the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, be approved prior to the 30th day after publication of notice of filing of Amendment Nos. 2 and 3 in the Federal Register. The changes proposed in Amendment Nos. 2 and 3, discussed above, are either technical in nature, raise policy issues that we have considered previously (and address them in a manner consistent with our prior approvals), do not differ substantively from the changes proposed in the original filing as modified by Amendment No. 1, notice of which was published for public comment in the Federal Register on July 23, 2008, or strengthen the proposal.

For example, NYSE's commitment in Amendment No. 2 to provide certain data to enable us to evaluate the effects of the Pilot provisions strengthens the proposal by specifying what data the Exchange must provide and when it must be provided. Clarification of the Exchange's implementation schedule for the New Model Pilot in Amendment No. 3 strengthens the proposal by setting a deadline of ten weeks following the date of this order by which the Exchange will fully implement the Pilot provisions, and thus eliminate the DMM's advance "look" at incoming orders.

Accordingly, we find that good cause exists, consistent with Sections 6(b)(5) of the Act,[99] and Section 19(b) of the Act[100] to approve the proposed rule change, as modified by Amendment Nos. 1 2, and 3 on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2008-46 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2008-46. 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. We will post all comments on the SEC's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with us, and all written communications relating to the proposed rule change between us and any person, other than those that may be withheld from the public in accordance with the provisions

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99 15 U.S.C. 78f(b)(5).

100 15 U.S.C. 78s(b).

of 5 U.S.C. 552, will be available for inspection and copying in the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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. All submissions should refer to File Number SR-NYSE-2008-46 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Conclusion

For the foregoing reasons, we find that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[101] that the proposed rule change (SR-NYSE-2008-46), as modified by Amendment Nos. 1, 2, and 3 be, and it hereby is, approved on an accelerated basis.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

101 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-28466; 812-13585]

Reserve Municipal Money-Market Trust, et al.; Notice of Application and Temporary Order

October 24, 2008

Agency: Securities and Exchange Commission ("Commission").

Action: Notice of application and a temporary order under Section 22(e)(3) of the Investment Company Act of 1940 (the "Act").

Summary of Application: Applicants request a temporary order to permit certain of their series to suspend the right of redemption of their outstanding redeemable securities and to postpone payment for shares which have been submitted for redemption for which payment has not been made.

Applicants: Reserve Municipal Money-Market Trust on behalf of two of its series, Arizona Municipal Money-Market Fund and Minnesota Municipal Money-Market Fund; Reserve Municipal Money-Market Trust II, on behalf of nine of its series, Interstate Tax-Exempt Fund, California Municipal Money-Market Fund, Connecticut Municipal Money-Market Fund, Florida Municipal Money-Market Fund, Michigan Municipal Money-Market Fund, New Jersey Municipal Money-Market Fund, Ohio Municipal Money-Market Fund, Pennsylvania Municipal Money-Market Fund and Virginia Municipal Money-Market Fund; Reserve New York Municipal Money-Market Trust on behalf of its single series, New York Municipal Money-Market Fund; and Reserve Short-Term Investment Trust on behalf of one of its series, Reserve Yield Plus Fund (Reserve Municipal Money-Market Trust, Reserve Municipal Money-Market Trust II, Reserve

New York Municipal Money-Market Trust, and Reserve Short-Term Investment Trust, collectively, the "Applicants" or the "Trusts," and each such series of Reserve Municipal Money-Market Trust, Reserve Municipal Money-Market Trust II and Reserve New York Municipal Money-Market Trust, a "Money Market Fund").

Filing Date: The application was filed on October 14, 2008 and amended on October 24, 2008.

Hearing or Notification of Hearing: Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 pm on [insert date 15 days after date of publication in the Federal Register], and should be accompanied by proof of service on Applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants, 1250 Broadway, New York, NY 10001-3701.

For Further Information, Contact: Brian P. Murphy, Senior Counsel, at (202) 551-6825 (Division of Investment Management, Office of Chief Counsel).

Supplementary Information: The complete application may be obtained for a fee at the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1520 (tel. 202-551-5850).

Applicants' Representations:

1. Each of the Money Market Funds and the Reserve Yield Plus Fund (collectively, the "Funds") is an open-end management investment company registered with the Commission under the Act. Each Money Market Fund is a money market fund that operates in a manner consistent with Rule 2a-7 under the Act and that seeks a high level of short-term interest income exempt from certain taxes as is consistent with the preservation of capital and liquidity. The Reserve Yield Plus Fund seeks as high a level of current income as is consistent with the preservation of capital and liquidity.

2. The Funds have been subject to a heavy level of redemption requests. For example, from September 12, 2008 to October 8, 2008, the total net assets of some of the Funds have declined as follows: (1) the Interstate Tax-Exempt Fund's total net assets declined from \$1.78 billion to \$154.6 million; (2) the Michigan Municipal Money-Market Fund's total net assets declined from \$29.1 million to \$5.3 million; (3) the New Jersey Municipal Money-Market Fund's total net assets declined from \$72.2 million to \$20.9 million; (4) the Ohio Municipal Money-Market Fund's total net assets declined from \$30.9 million to \$5.6 million; (5) the Pennsylvania Municipal Money-Market Fund's total net assets declined from \$74.4 million to \$2.6 million; and (6) the New York Municipal Money-Market Fund's total net assets declined from \$180.7 million to \$91.8 million. The decline of each Fund's total net assets was largely caused by heavy redemption requests and not declining values associated with portfolio holdings. There has been no abatement of the redemptions, and there is no reasonable basis for believing that redemptions will abate.

3. The Funds' have made efforts to raise cash to satisfy redemptions from the Funds through the sale of certain short-term portfolio securities or maturation of other

portfolio securities. The Funds are or soon will be limited in the amount of portfolio securities that can be sold at or above amortized cost or that will mature in seven days or less. The Funds' other portfolio securities can only be sold at below amortized cost (possibly at fire-sale prices) due to the extreme illiquidity and limited bids in the markets. In the view of the boards of trustees of each Trust, including a majority of the trustees who are not interested persons of such Trust within the meaning of Section 2(a)(19) of the Act, (the "Boards"), and the investment adviser (the "Adviser"), such sales would be inconsistent with the Funds' investment objectives of preservation of capital and harmful to non-redeeming shareholders.

4. In response to these developments, on October 8, 2008, the Boards, taking into account the recommendations of the Adviser, determined to liquidate the Funds.

5. On October 8, 2008, the Boards also determined that it would be in the best interest of each Fund's shareholders to suspend the right of redemption and postpone the date of payment or satisfaction upon redemption for more than seven days to allow Applicants the ability to liquidate the portfolio securities of the Funds in an orderly manner and allow the additional securities held by each Fund to mature. In addition, the Boards determined to request an order under Section 22(e)(3) of the Act.

Applicants' Legal Analysis:

1. Section 22(e)(1) of the Act generally provides that a registered investment company may not suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its designated agent except for any period during which the New York Stock Exchange ("NYSE") is

closed other than customary week-end and holiday closings, or during which trading on the NYSE is restricted.

2. Section 22(e)(2) of the Act provides that the seven-day redemption period does not apply for any period during which an emergency exists, as determined by Commission rules and regulations, as a result of which the disposal by a registered investment company of portfolio securities is not reasonably practicable or it is not reasonably practicable for the registered investment company fairly to determine the value of its net assets.

3. Section 22(e)(3) of the Act provides that redemptions may be suspended by a registered investment company for such other periods as the Commission may by order permit for the protection of security holders of the registered investment company.

4. Applicants submit that granting the requested relief is for the protection of each Fund's shareholders, as provided in Section 22(e)(3) of the Act. Applicants assert that, in requesting an order by the Commission, the Boards' goal is to ensure that each of the Funds' shareholders will be treated appropriately in view of the otherwise detrimental effect on each Fund of the recent unprecedented illiquidity of the markets and extraordinary levels of redemptions that the Funds have experienced. Current market conditions continue to be extraordinary, and the requested relief is intended to cause an orderly liquidation of each of the Funds' portfolio securities and ensure that all of their respective shareholders are protected in the process.

5. Applicants further submit that the relief is appropriate because: (1) the Boards: (a) taking into account the recommendations of the Adviser, determined on October 8, 2008 to liquidate the Funds, (b) determined, on October 8, 2008, that a

suspension of redemption is in the best interest of each Fund's shareholders, (c) determined, on October 8, 2008, that a postponement of payment for shares which have been submitted for redemption for which payment has not been made is in the best interest of each Fund's shareholders, and (d) promptly will create plans for the orderly liquidation of each Fund's assets and for the appropriate payments to each Fund's shareholders, including those whose redemption orders have been received but not yet paid, which plans will be subject to Commission supervision and which plans will include a planned schedule of possible payments to Fund shareholders that is based on the maturities of the portfolio securities held by each Fund; (2) each Fund has previously suspended sales as of September 18, 2008; (3) each Fund will make and keep appropriate records surrounding these events; and (4) each Fund continuously will provide timely and appropriate information, including initial and ongoing disclosure about the plan and its implementation, to its shareholders, via Web site or otherwise.

Commission Finding:

Based on the representations in the application, including those relating to the current extraordinary market conditions and the Boards' October 8, 2008 determinations, the Commission permits the temporary suspension of the right of redemption and postponement of payment for shares which have been submitted for redemption for which payment has not been made by the Funds for the protection of the Funds' security holders. Under the circumstances described in the application, which require immediate action to protect the Funds' security holders, the Commission concludes that it is not practicable to give notice or an opportunity to request a hearing before issuing the order.

In addition, under the circumstances described in the application, the Commission concludes that the order should be effective as of the date of the actions of the Boards.

IT IS ORDERED, pursuant to Section 22(e)(3) of the Act, that the requested relief from Section 22(e) of the Act is granted with respect to each Fund until that Fund has liquidated, or until the Commission rescinds the order granted herein. This order shall be in effect as of October 8, 2008.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 27, 2008

In the Matter of **Hat Trick Beverage, Inc.** **File No. 500-1**	:	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that the public interest and the protection of investors require a suspension of trading in the securities of Hat Trick Beverage, Inc. because there is a lack of current and accurate information concerning its securities. Questions have arisen concerning the accuracy and adequacy of statements in the company's press releases regarding its business operations. Hat Trick Beverage, Inc., a company that has made no public filings with the Commission, is quoted on the Pink Sheets under the ticker symbol HKBV.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of

1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT, October 27, 2008, through 11:59 p.m. EDT, on November 7, 2008.

By the Commission.

Florence E. Harmon
Acting Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

5. Amend §270.0-2 by:

a. Removing the last sentence in paragraph (b):

b. Revising paragraph (d);

c. Removing paragraph (g);

d. Redesignating paragraph (h) as paragraph (g); and

e. Removing the authority citation following the section.

The revision reads as follows:

§ 270.0-2 General requirements of papers and applications

* * * * *

(d) Verification of applications and statements of fact. Every application for an order under any provision of the Act, for which a form with instructions is not specifically prescribed and every amendment to such application, and every statement of fact formally filed in support of, or in opposition to, any application or declaration shall be verified by the person executing the same. An instrument executed on behalf of a corporation shall be verified in substantially the following form, but suitable changes may be made in such form for other kinds of companies and for individuals:

The undersigned states that he or she has duly executed the attached _________ dated ____, 20 ___ for and on behalf of (name of company) ______; that he or she is __(title of officer)___ of such company; and that all action by stockholders, directors, and other bodies necessary to authorize the undersigned to execute and file such instrument has been taken. The undersigned further states that he or she is familiar with such instrument, and the contents thereof, and that the facts therein set forth are true to the best of his or her knowledge, information and belief.

____

(Signature)

*   *   *   *   *

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 29, 2008

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 232 and 270

[Release Nos. 33-8981; 34-58874; IC-28476 File No. S7-25-07]

RIN 3235-AJ81

Mandatory Electronic Submission of Applications for Orders under the Investment Company Act and Filings Made Pursuant to Regulation E

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting several amendments to rules regarding our Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Specifically, we are amending our rules to make mandatory the electronic submission on EDGAR of applications for orders under any section of the Investment Company Act of 1940 ("Investment Company Act") as well as Regulation E filings of small business investment companies and business development companies. We also are amending the electronic filing rules to make the temporary hardship exemption unavailable for submission of applications under the Investment Company Act. Finally, we are amending Rule 0-2 under the Investment Company Act, eliminating the requirement that certain documents accompanying an application be notarized and the requirement that applicants submit a draft notice as an exhibit to an application.

EFFECTIVE DATE: January 1, 2009.

FOR FURTHER INFORMATION CONTACT: If you have questions about the rules, please contact one of the following members of our staff in the Division of Investment Management, at the Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-0506: in the Office of Legal and Disclosure, Ruth Armfield Sanders, Senior Special Counsel (EDGAR), at (202) 551-6989; in the Office of Investment Company Regulation, Michael W. Mundt, Assistant

Director, at (202) 551-6821; or, in the Office of Insurance Products, Keith Carpenter, Senior Special Counsel, at (202) 551-6766; for technical questions relating to the EDGAR system, in the Office of Information Technology, Richard D. Heroux, EDGAR Program Manager, at (202) 551-8168.

SUPPLEMENTARY INFORMATION:

The Securities and Exchange Commission ("Commission") is adopting amendments to Rules 101 and 201 of Regulation S-T[1] relating to electronic filing on the EDGAR system and to Rule 0-2[2] under the Investment Company Act.[3]

I. BACKGROUND

In the last several years, we initiated a series of amendments to keep EDGAR current technologically and to make it more useful to the investing public and Commission staff.[4] In April 2000, we adopted rule and form amendments in connection with the modernization of EDGAR.[5] In the Modernization Proposing Release, we noted that, as the use of electronic

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1 17 CFR 232.101 and 232.201.

2 17 CFR 270.0-2.

3 We proposed these amendments in November 2007. See Rulemaking for EDGAR System; Mandatory Electronic Submission of Applications for Orders under the Investment Company Act and Filings Made Pursuant to Regulation E, Release No. 33-8859 (Nov. 1, 2007) [72 FR 63513 (Nov. 9, 2007)] ("Proposing Release").

4 We recently announced the successor to the EDGAR Database. The new system is called IDEA, short for Interactive Data Electronic Applications, and will at first supplement and then eventually replace the EDGAR system. See "SEC Announces Successor to EDGAR Database; "IDEA" Will Make Company and Fund Information Interactive," Press Release No. 2008-179, Aug. 19, 2008.

5 See Rulemaking for EDGAR System, Release No. 33-7855 (Apr. 27, 2000) [65 FR 24788] (the "Modernization Adopting Release"). See also Release No. 33-7803 (Mar. 3, 2000) [65 FR 11507] ("Modernization Proposing Release").

databases grows, it becomes increasingly important for members of the public to have electronic access to our filings. We also stated that we were contemplating future rulemaking to require more of our filings to be filed on EDGAR. In May 2002, we adopted rules requiring foreign private issuers and foreign governments to file most of their documents electronically.[6] In May 2003, we adopted rules requiring electronic filing of beneficial ownership reports filed by officers, directors and principal security holders under Section 16(a)[7] of the Securities Exchange Act of 1934 ("Exchange Act").[8] In July 2005, we adopted rules requiring certain open-end management investment companies and insurance company separate accounts to identify in their EDGAR submissions information relating to their series and classes (or contracts, in the case of separate accounts) and mandating that fidelity bonds filed under Section 17(g)[9] and sales literature filed with us under Section 24(b)[10] be made by electronic submission on the EDGAR system.[11] In December 2006, we adopted amendments to the rules and forms under Section 17A of the Exchange Act requiring that the forms filed with respect to transfer agent registration, annual reporting, and withdrawal from registration be filed with the Commission electronically

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6 See Mandated EDGAR Filing for Foreign Issuers, Release No. 33-8099 (May 14, 2002) [67 FR 36678].

7 15 U.S.C. 78p(a).

8 See Mandated EDGAR Filing and Web Site Posting for Forms 3, 4 and 5, Release No. 33-8230 (May 7, 2003) [68 FR 25788] (the "EDGAR Section 16 Release").

9 15 U.S.C. 80a-17(g).

10 15 U.S.C. 80a-24(b).

11 See Rulemaking for EDGAR System, Release No. 33-8590 (July 18, 2005) [70 FR 43558 (July 27, 2005)].

on EDGAR.[12] On February 6, 2008, we adopted amendments to make mandatory the electronic submission of Form D on the EDGAR system.[13]

Today, we are amending our rules to require that applicants submit electronically on the EDGAR system their applications for orders under any section of the Investment Company Act ("applications"). In addition, we are adding Regulation E filings to the list of those that must be filed electronically through EDGAR. These amendments are designed to facilitate the efficient submission of applications and Regulation E filings, to enable the public to access them more quickly and search them more easily, and to improve the Commission's ability to track and process such applications and Regulation E filings. We are also making related amendments to Regulation S-T, our electronic filing rules, and revising Rule 0-2.

II. MANDATORY ELECTRONIC SUBMISSION OF INVESTMENT COMPANY APPLICATIONS

The rules under Regulation S-T previously provided that applications for exemptive relief under any section of the Investment Company Act shall not be made in electronic format.[14] The only applications under the Investment Company Act that were mandatory EDGAR submissions were applications for deregistration filed by investment companies.[15] Applicants for orders

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12 See Electronic Filing of Transfer Agent Forms, Release No. 34-54864 (Dec. 4, 2006) [71 FR 74698 (Dec. 12, 2006)].

13 See Electronic Filing and Revisions of Form D, Release No. 33-8891 (Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)].

14 Rule 101(a)(1)(iv) and (c)(11) of Regulation S-T [17 CFR 232.101(a)(1)(iv) and (c)(11)].

15 These include applications and amendments submitted on Form N-8F [17 CFR 274.218] (EDGAR submission types N-8F and N-8F/A) and those submitted pursuant to Investment Company Act Rule 0-2 [17 CFR 270.0-2] (EDGAR submission types 40-8F-2 and 40-8F-2/A). See Release No. IC-23786 (Apr. 15, 1999) [76 19469 (Apr. 21, 1999)].

under the Investment Company Act can include registered investment companies, affiliated persons of registered investment companies, and issuers seeking to avoid investment company status, among other entities.[16] These applications were submitted in paper and available only from the Commission's public reference room or electronically from private services. Private services usually charge fees for electronic copies of applications; also, there is a delay of about thirty days between the submission of applications to the Commission and their electronic availability from the private sources.

We are amending certain provisions of Regulation S-T and Investment Company Act Rule 0-2[17] to require electronic submission on EDGAR of applications pursuant to Rule 0-2 under the Investment Company Act. We are amending Rule 101(a)(1)(iv) of Regulation S-T to include within its mandatory electronic filing provisions any application for an order under any section of the Investment Company Act.[18]

In the Proposing Release, we requested comment on the impact of our making the submission of requests for orders under the Investment Company Act mandatory electronic submissions and whether we should implement this rule. We requested comment on whether it

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16 There are several sections of the Investment Company Act pursuant to which entities may make applications for relief. For example, Section 6(c) [15 U.S.C. 80a-6(c)] provides the Commission with authority to exempt persons, securities or transactions from any provision of the Investment Company Act, or the regulations thereunder, if and to the extent that such exemption is in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Investment Company Act.

17 Rule 0-2 is the Investment Company Act rule under which applications are submitted.

18 See amendment to Rule 101(a)(1)(iv) under Regulation S-T. Paragraph (11) of Rule 101(c) provided that filings under Section 6(c) of the Investment Company Act, i.e., applications for orders, be submitted in paper format only. As proposed, we are removing and reserving this paragraph.

would be burdensome for us to require applicants to submit applications electronically. We also sought comments as to which applications the rule should apply. We asked commenters to address the issue of what the transition period should be for investment companies and other applicants to prepare for the mandatory electronic submission of these applications.

We requested comment not only on the specific issues that we discussed in the Proposing Release, but on any other approaches or issues that we should consider in connection with the submission of applications for orders and Regulation E filings on the EDGAR system. We sought comment from any interested person, including those required to file information with us on the EDGAR system, as well as investors, disseminators of EDGAR data, EDGAR filing agents, and other members of the public who have access to and use information from the EDGAR system.

We asked commenters to provide detailed information on any difficulties and considerations unique to these proposed requirements. In the event commenters believed that any aspect of the proposed requirements would be burdensome, we asked for specific details and alternative approaches.

We received two comment letters in response to our requests for comment. Both commenters expressed support for the rulemaking proposal to require that all applications be submitted electronically through the EDGAR system.[19] Both commenters expressed views about

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19 In support of the proposal, one commenter stated:

> Like the Commission, the Institute believes that the proposal will help to facilitate both the efficient submission of applications and the retrieval of those applications by interested parties. We also applaud this effort by the Commission to improve its ability to track and process exemptive applications, which are of vital importance to the fund industry and, ultimately, to fund investors.

applications that are sent to the staff in draft that have not been officially filed. One commenter inquired about applications made under both the Investment Company Act and the Investment Advisers Act of 1940 ("Investment Advisers Act")[20] and had certain concerns about amendments to Rule 0-2.[21] We received no comments in connection with the portion of our proposal related to Regulation E filings.

We are adopting these amendments, in light of the primary goals of the EDGAR system, to facilitate the rapid dissemination of financial and business information in connection with filings, including filings by investment companies. Requiring applications to be submitted electronically will benefit members of the investing public and the financial community by making information contained in these filings readily available and more easily searchable. In this age of information, we believe that filings and applications made with the Commission are more valuable to the public if they are available in electronic form and that adding applications to the EDGAR database will provide a more complete picture for the investing public. We believe that the amendments will benefit the public by making the EDGAR page of our Web site a more comprehensive resource for most information on file with us related to the operation of investment companies.

Both of the commenters on the Proposing Release raised the issue of applications submitted to the Commission's staff in draft form. One commenter strongly believed that "the

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See Comment Letter dated Dec. 14, 2007, of Karrie McMillan, General Counsel, Investment Company Institute (the "ICI Comment Letter"). See also Comment Letter dated Dec. 14, 2007, of Mercer Bullard, Founder and President, Fund Democracy (the "Fund Democracy Comment Letter").

20 15 U.S.C. 80b-1 et seq.

21 See ICI Comment Letter.

Commission staff's willingness to consider exemptive applications in draft form and to grant requests for confidential treatment, when appropriate, is critical to encouraging innovation in the fund industry."[22] The other commenter was concerned that the new filing requirement might result in an increase of the use of draft applications to the detriment of the public interest.[23]

The staff's policy, as first stated in a Commission release in 1985, is that the staff will not, except in the most extraordinary situations, review draft applications.[24] Consistent with this policy, the staff will continue to accept draft applications only in situations where the applicant clearly demonstrates the extraordinary circumstances that necessitate the submission of a draft application.[25] We believe that this approach continues to strike an appropriate balance between encouraging

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22 See ICI Comment Letter. In support of its position, the commenter stated:

> The development of new investment products and more efficient and effective business practices can be a costly and time-consuming endeavor for fund sponsors and other applicants. In return for their investment of intellectual and financial capital, applicants should be rewarded for their innovation and creativity by being the "first to market" with their new product or practice.

23 Noting this concern, the commenter stated that:

> Permitting applicants to file draft applications is contrary to fundamental principles of administrative law and the public interest. It also is unfair to other applicants for Commission staff to spend time on draft applications while applications that have been properly filed are left on hold. In its adopting release, the Commission should clarify that the staff will not accept or review draft applications, and that concerns regarding the confidentiality of proprietary information should be addressed by appropriate redactions in a filed request.

See Fund Democracy Comment Letter.

24 See Commission Policy and Guidelines for Filing of Applications for Exemption, Investment Company Act Release No. 14492 (Apr. 30, 1985).

25 See IM Exemptive Application Processing, SEC Office of the Inspector General, Audit Report No. 408, Recommendation C (Sept. 29, 2006).

innovation in the fund industry, making effective use of staff resources, and serving the interests of the public. While it is possible that applicants will seek permission to submit more applications as draft applications, as discussed above the staff's policy of reviewing draft applications only in the most extraordinary situations will not change, and as a result, we do not believe that the number of draft applications will increase. The new filing requirement will only change the format (from paper to electronic) of documents that were and will be publicly available.

As we noted in the Proposing Release, from time to time, an applicant may wish to submit an application for exemption under both the Investment Company Act and the Investment Advisers Act.[26] We did not propose to require that applications under the Investment Advisers Act be made on EDGAR. We noted that any document that is intended as an application for an order under both the Investment Company Act and the Investment Advisers Act should be submitted separately under each Act.

One commenter expressed the view that we should consider alternative approaches that would allow a single EDGAR filing for an application requesting relief under both Acts.[27] We note that, to date, the EDGAR system has not been a vehicle for the submission of Investment Advisers Act filings. Further, based on staff review of the contents of all Advisers Act applications submitted to us, we are not aware of any within the past ten years that also requested relief from Investment Company Act provisions. Therefore, we believe it is not cost-effective for us to make the programming changes at this time so that EDGAR would accept applications

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[26] See footnote 18 of the Proposing Release.

[27] See ICI Comment Letter.

under both Acts, given that recently no applications requested relief from both statutes. EDGAR will accept applications under the Investment Company Act as proposed.

As with other entities that make submissions on EDGAR, applicants will be subject to the provisions of Regulation S-T[28] and the EDGAR Filer Manual. Regulation S-T includes detailed rules concerning mandatory and permissive electronic EDGAR submissions; it also makes clear that requests for confidential treatment must be made in paper format.[29]

Regulation S-T requires the electronic filing of any amendments and related correspondence and supplemental information pertaining to a document that is the subject of mandated EDGAR submission.[30] These requirements also apply to companies and persons who submit applications.[31] The requirement to file amendments electronically applies to applications filed electronically on EDGAR as well as to pending applications initially filed in paper.[32]

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28 For a comprehensive discussion of Regulation S-T and electronic filing, see "Electronic Filing and the EDGAR System: A Regulatory Overview," available on the Information for EDGAR Filers page of the Commission's Web site, www.sec.gov/info/edgar.shtml.

29 See Rule 101 of Regulation S-T [17 CFR 232.101].

30 Regulation S-T Rule 101(a)(2) [17 CFR 232.101(a)(2)].

31 See amendments to paragraphs (a)(2) and (3) of Rule 101 of Regulation S-T. Related correspondence and supplemental information are not automatically disseminated publicly through the EDGAR system but are immediately available to the Commission staff.

32 This provision dates back to 1993. See text at footnote 83 of Rulemaking for EDGAR System, Release No. 33-6977 (Feb. 23, 1993) [58 FR 14628 (Mar. 18, 1993)] ("Once a filer becomes subject to the mandated electronic filing rules, any documents, including amendments and supplements to documents previously filed in paper, will be required to be filed in electronic format, absent a hardship exemption.").

The Regulation also covers such matters as providing for the override of formatting requirements applicable to paper submissions.[33] The EDGAR Filer Manual contains detailed technical specifications concerning EDGAR submissions. The Manual also provides technical guidance concerning how to commence submissions on EDGAR by submitting Form ID to obtain a CIK[34] and confidential access codes and how to maintain and update company data, e.g., how to change company names and contact information.[35]

One technical specification that the EDGAR Filer Manual includes is the electronic "submission type" for each submission made on EDGAR. The EDGAR electronic submission types for applications are designed to facilitate and expedite the review of these applications.

Consistent with our amendments, the EDGAR Filer Manual and the EDGARLink software provide for three EDGAR electronic submission types for applications: 40-APP, 40-OIP, and 40-6B. Applicants whose applications are typically processed by the Division of Investment Management's Office of Investment Company Regulation will use EDGAR submission type 40-APP; these applicants will submit amendments using EDGAR submission type 40-APP/A. Applicants whose applications are typically processed by the Division's Office of Insurance Products will use the new EDGAR submission type 40-OIP; these applicants will submit amendments using EDGAR submission type 40-OIP/A. Employees' securities company

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33 The paper formatting requirements continue to be applicable to paper submissions made pursuant to temporary and continuing hardship exemptions under Rules 201 and 202 of Regulation S-T [17 CFR 232.201 and 232.202].

34 A filer's CIK (or "central index key") is a ten-digit number uniquely identifying that filer.

35 We remind filers that, in the case of name changes, the changes must be made via the EDGAR filing Web site in advance of the change being reflected on an EDGAR submission. The name on past submissions will not change. The CIK and file number(s) of the company will provide a link to filings under the old name.

applications (also processed by the Office of Investment Company Regulation) will use EDGAR submission type 40-6B and submission type 40-6B/A for amendments. Applicants that have currently pending applications that were submitted in paper and recorded as submission type 40-6C will submit amendments to their applications using either EDGAR submission type 40-APP/A or 40-OIP/A, as appropriate.

The EDGAR Filer Manual provides guidance for applicants in choosing the correct submission type. Most applicants will submit their applications under EDGAR submission type 40-APP, the submission type designated for the Office of Investment Company Regulation. Applicants submitting the following categories of applications will use EDGAR submission type 40-OIP, the submission type for the Office of Insurance Products:

(1) applications with regard to mixed and shared funding filed under Section 6(c) of the Investment Company Act, for exemptions from the provisions of Sections 9(a), 13(a), 15(a) and 15(b) of the Investment Company Act,[36] and Rules 6e-2(b)(15) and 6e-3(T)(b)(15);[37]

(2) applications relating to the recapture of bonus credits filed under Section 6(c) of the Investment Company Act for exemptions from the provisions of Sections 2(a)(32) and 27(i)(2)(A) of the Investment Company Act[38] and Rule 22c-1;[39]

(3) applications relating to the substitution of securities held by a variable insurance separate account filed under Section 26(c) of the Investment Company Act;[40] and

(4) applications for approval of the terms of an exchange offer involving variable insurance

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36 15 U.S.C. 80a-9(a), 80a-13(a), 80a-15(a), 80a-15(b).

37 17 CFR 270.6e-2(b)(15), 270.6e-3(T)(b)(15).

38 15 U.S.C. 80a-2(a)(32), 80a-27(i)(2)(A).

39 17 CFR 270.22c-1.

40 15 U.S.C. 80a-26(c).

contracts filed under Section 11(a) of the Investment Company Act.[41]

These three submission types are designed to facilitate and expedite staff review of the submissions. Our internal system will quickly route the application to the appropriate Office. If applicants have any questions as to the appropriate EDGAR submission type, we encourage them to verify in advance the correct submission type so that the application can be routed automatically to the appropriate Office.[42] As proposed, for applications with multiple co-applicants, the applicants will submit the application with all co-applicants included in one submission. The applicants will choose one applicant to list first as the "primary" co-applicant. Then, they will include in the EDGAR template the information for all other co-applicants, i.e., the CIK of each co-applicant and, for amendments, the file number assigned to each co-applicant when the original application was filed. Applicants can be dropped from or added to an application with each amendment submission.[43]

Our internal EDGAR system has been enhanced to allow for the upload and public dissemination via the EDGAR system of notices and orders in connection with applications. These documents will, of course, still be available in the Federal Register. The staff will commence the upload and dissemination of notice and orders on the EDGAR system as of the

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41 15 U.S.C. 80a-11(a).

42 In case of doubt, applicants may call the IM EDGAR Inquiry Line (202-551-6989) in the Division of Investment Management for assistance.

43 As is the case currently with paper applications, for each application, an applicant will receive a unique file number which will begin with the prefix "812," or "813" in the case of applications made by employees' securities companies. As also is currently the case with paper filings, each co-applicant's file number will be composed of the primary applicant's file number with an appended numerical suffix unique to that co-applicant. Each applicant or co-applicant will include this file number, in addition to its CIK, in the EDGAR template of all amendments to the application, which will also be required electronic submissions.

effective date of the amendments. The staff will upload and disseminate any notice or order issued on or after the effective date, regardless of whether the application, or any amendment to it, was submitted in paper or on EDGAR.

We asked commenters to address the issue of what the transition period should be for investment companies and other applicants to prepare for the mandatory electronic submission of these applications. We received no comments in response to this request other than the comments regarding draft applications. We believe applicants are prepared to submit their applications electronically on EDGAR as soon as our amendments become effective.

III. AMENDMENTS TO RULE 0-2 AND TO TEMPORARY HARDSHIP EXEMPTION OF REGULATION S-T

Rule 0-2 requires that every application for an order for which a form is not specifically prescribed and which is executed by a corporation, partnership or other company and filed with the Commission contain a statement of the applicable provisions of the articles of incorporation, bylaws or similar documents, relating to the right of the person signing and filing such application to take such action on behalf of the applicant, and a statement that all such requirements have been complied with and that the person signing and filing the application is fully authorized to do so. If such authorization is dependent on resolutions of stockholders, directors, or other bodies, such resolutions must be attached as an exhibit to or quoted in the application. Any amendment to the application must contain a similar statement as to the applicability of the original statement of authorization. When any application or amendment is signed by an agent or attorney, Rule 0-2 requires that the power of attorney evidencing his authority to sign shall state the basis for the agent's authority and shall be filed with the Commission. Every application subject to Rule 0-2 must be verified by the person executing the application by providing a notarized signature in substantially the form specified in the rule. Each application subject to Rule 0-2 must state the reasons why the applicant is deemed to be entitled to the action requested, the name and address of each applicant, and the name and address of any person to whom any questions regarding the application should be directed. Rule 0-2 requires that a proposed notice of the proceeding initiated by the filing of the application accompany each application as an exhibit and, if necessary, be modified to reflect any amendment to the application.

We proposed three amendments to Rule 0-2 governing the form of applications under the Investment Company Act and requested comment on these proposed amendments. The commenters supported the proposed amendments to Rule 0-2, and we are adopting these amendments as proposed. First, we are eliminating the requirement to have verifications of applications and statements of facts made in connection with applications notarized.[44] We believe that this requirement is unnecessary in the context of an electronic filing.[45] Second, we are eliminating the requirement that applicants include draft notices as exhibits to applications.[46] The staff has found these exhibits to be of limited value because the staff prefers to draft its own notices of applications. Finally, we are amending Rule 0-2 to remove the last sentence of

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[44] See Rule 0-2(d).

[45] Regulation S-T requires that each signatory to an electronic filing manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form in the electronic filing. This document must be executed before or at the time the electronic filing is made, must be retained by the filer for a period of five years, and must be made available to the Commission upon request. See Rule 302(b) of Regulation S-T [17 CFR 232.302(b)]. We believe that this requirement provides sufficient assurance of the legitimacy of signatures contained in the electronic filings so that notarization is unnecessary.

[46] See Rule 0-2(g).

paragraph (b),[47] which was added in the initial EDGAR rulemaking and is inconsistent with mandatory electronic submission of applications on EDGAR.[48]

One commenter suggested that we further amend Rule 0-2 by eliminating from paragraph (c)(1) the requirement that a copy of any board resolution authorizing the actions of the person signing and filing the application be included as an exhibit to the application (or, alternatively, that the pertinent provisions of such resolution be quoted in the application).[49]

Because this suggestion goes beyond the scope of our proposal, we are not adopting the recommendation at this time. We may consider this recommendation in the future.

We proposed and are adopting an amendment to Rule 201 of Regulation S-T. Rules 201 and 202[50] of Regulation S-T address hardship exemptions from EDGAR filing requirements, and Rule 13(b) of Regulation S-T[51] addresses the related issue of filing date adjustments.

A filer may obtain a temporary hardship exemption under Rule 201 if it experiences

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47 The last sentence of Rule 0-2(b) read as follows: "Every application for an order under any provision of the Act and every amendment to such application shall be submitted to the Commission in paper only, whether or not the applicant is otherwise required to file in electronic format, unless instructions for electronic filing are included on the form, if any, prescribed for such application."

48 See Rulemaking for EDGAR System – Investment Companies and Institutional Investment Managers, Release No. 33-6978 (Feb. 23, 1993) [58 FR 14848 (Mar. 18, 1993)].

49 See ICI Comment Letter. The commenter also noted:

> In our view, this requirement is unnecessary because the person signing the application is required to attest to such resolutions in the verification required by paragraph (d) of the rule. We further note that board resolutions do not have to be submitted with other types of filings with the Commission, such as fund registration statements and proxy statements, nor are we aware of any history of abuse that would suggest this requirement must be maintained.

50 17 CFR 232.202.

51 17 CFR 232.13(b).

unanticipated technical difficulties that prevent the timely preparation and submission of an electronic filing by filing a properly legended paper copy[52] of the filing under cover of Form TH.[53] This process is self-executing. A filer who files in paper under the temporary hardship exemption must submit an electronic format copy of the filed paper document within six business days of the filing of the paper format document.[54]

A filer may apply for a continuing hardship exemption under Rule 202 if it cannot file all or part of a filing without undue burden or expense.[55] In contrast to the self-executing temporary hardship exemption process, a filer can obtain a continuing hardship exemption only by submitting a written application, upon which the Commission, or Commission staff pursuant to delegated authority, may then act.

We proposed making the temporary hardship exemption unavailable for submission of applications under the Investment Company Act, since there is generally no submission exigency or submission deadline associated with these submissions. We asked for comments on this proposed amendment. We received one comment questioning whether, if this provision were adopted, the staff would work with applicants that need additional time to file amendments, to prevent applications from being placed in an inactive status.[56] As has been the practice in the past,

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52 See 17 CFR 232.201(a).

53 17 CFR 239.65, 249.447, 269.10, and 274.404.

54 See 17 CFR 232.201(b).

55 See 17 CFR 232.202(a).

56 See ICI Comment Letter. The staff typically places applications in an inactive status if the applicant does not respond to staff comments within sixty days of receiving the comments, such as by filing an amendment.

the staff will continue to work with applicants experiencing unanticipated technical or other difficulties to establish appropriate timeframes for the submission of amendments and ensure the timely processing of all applications.

We are amending Rule 201(a) of Regulation S-T as proposed to make the temporary hardship exemption unavailable for submission of applications under the Investment Company Act.[57] We restate our belief that there is generally no submission exigency or submission deadline associated with these submissions. An applicant will continue to have the ability to apply for a continuing hardship exemption under Rule 202 if it cannot submit all or part of an application without undue burden or expense. Also, while we expect the circumstances to be rare, the staff could use its delegated authority to grant a filing date adjustment pursuant to Rule 13(b) of Regulation S-T [17 CFR 232.13(b)]. While we do not expect an applicant to need a filing date adjustment in the context of an application, it will be available in the unlikely event it is needed. And, as stated above, the staff will continue to work with applicants experiencing unanticipated difficulties.

IV. AMENDMENTS TO MANDATE THAT CERTAIN FILINGS OF SMALL BUSINESS INVESTMENT COMPANIES AND BUSINESS DEVELOPMENT COMPANIES BE MADE ELECTRONICALLY

Regulation E[58] provides for the exemption from registration of securities issued by small business investment companies registered under the Investment Company Act and business

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57 See amendment to Rule 201(a) of Regulation S-T. As we noted in the Proposing Release, we have previously made unavailable the ability for filers to use the temporary hardship exemption for EDGAR submissions of beneficial ownership reports filed by officers, directors and principal security holders under Section 16(a) of the Exchange Act [15 U.S.C. 78p(a)]. See Mandated EDGAR Filing and Web Site Posting for Forms 3, 4 and 5, Release No. 33-8230 (May 7, 2003) [68 FR 25788].

58 17 CFR 230.601 to 230.610a.

development companies regulated under the Investment Company Act, subject to the terms and conditions of the regulation. Rule 604[59] of Regulation E requires the filing of notification on Form 1-E[60] of sales of securities under Regulation E. Rule 607[61] of Regulation E requires the filing of sales material used in connection with the offering. Rule 609[62] of Regulation E requires the filing of reports of sales on Form 2-E.[63]

We proposed that Regulation E filings be mandatory electronic filings on the EDGAR system. Regulation E filers make most of their filings electronically on the EDGAR system. Since these filers are already EDGAR filers and most will have available electronic copies of their Form 1-E (and any related sales material)[64] and Form 2-E, we believe that making these filings electronically on EDGAR will impose very little burden or cost on these companies. We requested but received no comment on this proposal. We are adopting the amendments as proposed, making these filings mandatory electronic submissions.[65]

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59 17 CFR 230.604.

60 17 CFR 239.200.

61 17 CFR 230.607.

62 17 CFR 230.609.

63 17 CFR 239.201.

64 Requiring electronic filing on EDGAR of Rule 607 sales literature is consistent with the requirement to file electronically on EDGAR omitting prospectuses under Rule 482 of the Securities Act of 1933 (the "Securities Act") (referred to as "482 ads") and sales literature under Section 24(b) of the Investment Company Act.

65 <u>See</u> amendments to paragraphs (a)(1)(v) and (c)(6) of Rule 101 of Regulation S-T.

V. EFFECTIVE DATE

Beginning on January 1, 2009, applications for orders under the Investment Company Act and Regulation E filings will become mandatory electronic submissions on the EDGAR system. This effective date will provide time for filers to prepare for the mandatory requirements. Also, since the effective date will be the start of a calendar year, the public will have a clear reference point for determining whether any particular application or Regulation E filing has been submitted either in paper or electronically.

VI. COST-BENEFIT ANALYSIS

We are sensitive to the costs and burdens of our rules. The rules we are adopting today reflect the addition of applications under the Investment Company Act as mandatory electronic submissions on EDGAR. In addition, they amend Rule 0-2 and make unavailable to applicants Regulation S-T's provision for temporary hardship exemptions. They also add Regulation E filings to the list of those that must be filed electronically through EDGAR.

A. Expected Benefits

We expect that the addition of applications under the Investment Company Act as mandatory electronic submissions on EDGAR will result in considerable benefits to the securities markets, investors, and other members of the public, by expanding the accessibility of information, and increasing the types of information, filed and made available for public review through the EDGAR system. The primary goal of the EDGAR system since its inception has been to facilitate the rapid dissemination of financial and business information in connection with filings, including filings by investment companies. The amendments will benefit investors, financial analysts and others by increasing the efficiency of retrieving and disseminating these applications. The mandated electronic transmission of these documents will enable the public to access them more quickly and search them more easily. Instead of having to come in person or through an agent to the Commission's public reference room to conduct a search for a particular submission that is in paper or microfiche, the public will be able to find and review the application on any computer with an Internet connection by accessing the EDGAR system through the Commission's Web site or through a third party Web site that links to EDGAR. We received one comment stating the belief that it is unlikely that investors would choose to access and review exemptive applications available via EDGAR.[66] We believe that these documents should be publicly available via EDGAR for any investors who do choose to access and review them.

The amendments will benefit the public by making the EDGAR page of our Web site a more comprehensive resource for most information on file with us related to the operation of investment companies. A further benefit will be to ensure that all applications are available to the public free of charge on our Web site without the cost of paying a third party for a copy.

Persons who may consider requesting a hearing on an application on the basis of a notice will be able to more easily obtain the actual application so that they can better evaluate the issues raised by the application. We believe this will be a significant improvement in the applications process.

We also expect that applicants will benefit from the increased efficiencies in the filing process for these submissions resulting from the amendments. By electronically transmitting these documents directly to the Commission, applicants will avoid the uncertainties and delays

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66 See ICI Comment Letter at footnote 7.

that can occur with the manual delivery of paper documents; we believe that it will be a simpler and more efficient means to submit applications. Applicants also will benefit from no longer having to submit multiple copies of paper documents to the Commission.

Because the Commission's staff will be able to retrieve and analyze information contained in these submissions more readily than under our current paper system, mandated electronic submission of these documents should facilitate the staff's retrieval and review of a particular document. Applicants and investors should benefit from increased efficiencies in the Commission's storage, retrieval, and analysis of these submissions which should result from the amendments.

We believe the amendments to Rule 0-2 will benefit applicants. Removing the notarization requirement will remove a requirement from filers that is unnecessary for electronic filings, and removing the requirement to include a draft notice as an exhibit will result in a cost-savings to applicants. And, we believe that making unavailable to applicants Regulation S-T's Rule 201 provision for temporary hardship exemptions will benefit applicants because applicants will not bear the cost of both submitting an application in paper and in electronic form as a confirming copy within six business days as required by the temporary hardship exemption rule. This is true in light of the fact that there is no deadline for the submission of an application.

We also expect that the addition of Regulation E filings as mandatory electronic submissions on EDGAR will result in benefits to the securities markets, investors, and other members of the public, by expanding the accessibility of information, and increasing the types of information, filed and made available for public review through the EDGAR system. Requiring these Regulation E filings to be submitted on EDGAR will benefit members of the investing public and the financial community by making information contained in these Commission filings more easily searchable and readily available to them. The amendments will result in the benefit to the public of the EDGAR page of our Web site being a comprehensive source from which to find filings of small business investment companies and business development companies.

We also expect that Regulation E filers will benefit from the amendments by increased efficiencies in the filing process for these submissions. By electronically transmitting these documents directly to the Commission, these filers will avoid the uncertainties and delays that can occur with the manual delivery of paper documents; we believe that it will be a simpler and more efficient means to submit these Regulation E filings. Regulation E filers also will benefit from no longer having to submit multiple copies of paper documents to the Commission.

The amendments will benefit investors, financial analysts and others by increasing the efficiency of retrieving and disseminating these filings. The mandated electronic transmission of these documents will enable the public to access them more quickly. Instead of having to come in person or through an agent to the Commission's public reference room to conduct a search for a particular submission that is in paper or microfiche, the public will be able to find and review the filing on any computer with an Internet connection by accessing the EDGAR system through the Commission's Web site or through a third party Web site that links to EDGAR. The amendments will also enable financial analysts and others to retrieve, analyze and disseminate more rapidly this information.

An investor will be able to more efficiently gather information of interest about Regulation E filers. Also, Regulation E filers and investors should benefit from the amendments by increased efficiencies in the Commission's storage, retrieval, and analysis of these submissions. Mandated EDGAR submission of these documents will result in their addition to the Commission's central electronic repository of filings that is free to anyone who has access to a computer linked to the Internet. Because the Commission's staff will be able to retrieve and analyze information contained in these Regulation E submissions more readily than under our current paper system, mandated electronic submission of these documents should facilitate the staff's retrieval and review of a particular document.

In the Paperwork Reduction Act section we estimate that, the amendments to Rule 0-2 will reduce the total burden by approximately $52,550 annually.

B. Expected Costs

We expect that the amendments will result in some initial and ongoing costs to applicants. We also expect, however, that many applicants will not bear the full range of costs that will result from the amendments for the reasons described below. Initial costs are those associated with filing a Form ID in order to obtain the access codes needed to submit an application electronically and otherwise preparing to make an application submission.[67] In order to file a Form ID, an applicant will need to learn the related electronic filing requirements, obtain access to a computer and the Internet, use the computer to access the Commission's EDGAR Filer Management Web site, respond to Form ID's information requirements and fax to the Commission a notarized authenticating document.

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[67] Applicants that already have EDGAR access codes will not need to file a Form ID. As further discussed in Part IX, however, we assume that a small number of applicants per year will not already have the codes.

Ongoing costs are those associated with maintaining the framework developed through the initial costs (for example, updating information required by Form ID) and additional costs arising from each subsequent submission of an application.

We expect that the vast majority of applicants will need to incur few, if any, additional costs related to obtaining computer and Internet access. We believe that the vast majority of applicants already will have access to a computer and the Internet.[68]

We expect no additional costs to applicants from amendments to Rule 0-2. We requested but received no comment on whether our amendments to Rule 0-2 to remove the current requirements for notarization and provision of a draft notice as an exhibit will result in any additional costs, although the two commenters supported these proposals. We expect no additional costs to applicants from our amendment to make unavailable to applicants Regulation S-T's Rule 201 provision for temporary hardship exemption. An applicant will still be able to request a continuing hardship exemption under Regulation S-T Rule 202 under appropriate circumstances.

We believe that mandatory EDGAR submission of Regulation E filings will result in minimal cost to these filers. For the following reasons, we also expect that Regulation E filers will not bear the full range of costs frequently associated with new electronic filing requirements. Initial costs are those associated with the purchase of compatible computer equipment and software, including EDGAR software if obtained from a third-party vendor and not from the Commission's Web site. Initial costs also include those resulting from the training of existing

68 An applicant that did not already own a computer with Internet access could, for example, go to a public library to use its computer and obtain Internet access.

employees to be EDGAR proficient or the hiring of additional employees or agents that are already skilled in EDGAR processing. Initial costs further include those associated with the formatting and transmission of an applicant's first document submitted on EDGAR. These transmission costs may include those related to subscribing to an Internet service provider. Regulation E filers already file on EDGAR and will have minimal or no initial costs.

Ongoing costs are those associated with the electronic formatting and transmission of subsequent EDGAR filings. Regulation E filers may also incur future costs resulting from the training or hiring of employees regarding updated EDGAR filing requirements. The magnitude of these costs will depend on the filers' levels of technological proficiency and their previous familiarity with EDGAR filing requirements. Regulation E filers will incur the ongoing costs associated with formatting and transmitting their subsequent EDGAR filings. Consequently, the mandated EDGAR requirements should result only in costs related primarily to the electronic formatting of these documents in a format compatible with EDGAR, and transmission of the EDGAR formatted documents to the Commission. In any event, we believe that any costs for transmission, formatting, and education will be comparable to savings from not having to incur similar costs related to paper submissions.

VII. BURDEN ON COMPETITION; PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act requires us, in adopting rules under the Exchange Act, to consider the anti-competitive effects of any rules that we adopt thereunder. Furthermore, Section 2(b) of the Securities Act,[69] Section 3(f) of the Exchange Act,[70] and Section 2(c)[71] of the Investment Company Act require us, when engaging in rulemaking, and considering or determining whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. We requested comment on whether the amendments, if adopted, will burden competition and whether they will promote efficiency, competition, and capital formation. We encouraged commenters to provide empirical data or other facts to support their views. We received no comments in response.

The amendments regarding mandated electronic filing of applications and the related amendments to Rule 0-2 and Regulation S-T's Rule 201 are intended to simplify the requirements for submitting applications and facilitate more efficient transmission, analysis, storage and retrieval of information. We believe this will improve the accessibility and usefulness of information available to all applicants and the public, including those wishing to request a hearing on an application. It may make the investment products offered by applicants more competitive, since all applicants will have ready access to the applications of others. We believe the amendments will also improve the accessibility of information available to the public and investors about the operation of investment companies. We believe the amendments will not impose a burden on competition and will not have an adverse impact on capital formation.

The amendments regarding mandated electronic filings under Regulation E by small business investment companies and business development companies are intended to facilitate

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69 15 U.S.C. 77b(b).

70 15 U.S.C. 78c(f).

71 15 U.S.C. 80a-2(c).

more efficient transmission, analysis, storage and retrieval of information. We believe this will improve the accessibility and usefulness of information available for use by filers, investors, and the public. It may make the investment products offered by filers more competitive, since all filers will have immediate on-line access to Regulation E filings of their competitors. We believe that the amendments will also improve the accessibility of information available to the public about the operation of small business investment companies and business development companies and thereby improve investors' ability to make informed investment decisions. We believe the amendments will not impose a burden on competition and will not have an adverse impact on capital formation.

VIII. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to our amendments adding applications for orders under the Investment Company Act to the list of submissions that must be made electronically, amendments to amend Rule 0-2 and make unavailable to applicants the provision for temporary hardship exemptions in Rule 201 of Regulation S-T, and amendments adding Regulation E filings to the list of those that must be filed electronically through EDGAR.

A. Need for the Rule Amendments

The amendments will require applications for orders under any section of the Investment Company Act to be submitted electronically on EDGAR. The amendments to Rule 0-2 remove the requirements for notarization and provision of a draft notice, and the amendments to Rule 201 of Regulation S-T make applications ineligible for temporary hardship exemptions. We make these amendments because the absence of an electronic system for submitting applications for orders in the past limited the usefulness of the information collected and to reduce the burdens of submitting applications.

The amendments add Regulation E filings made by small business investment companies and business development companies to the list of those that must be filed electronically through EDGAR. We also make these amendments because the absence of an electronic system for submitting Regulation E filings in the past limited the usefulness of the information collected.

B. Significant Issues Raised by Public Comment

In the Initial Regulatory Flexibility Act Analysis ("IRFA") for the proposed amendments, we encouraged the submission of written comments with respect to any aspect of the IRFA. We requested specifically comment on the number of small entities that will be affected by the amendments and the likely impact on small entities. We asked commenters to describe the nature of any impact and provide empirical data supporting the extent of the impact. We received no comments with respect to this section of the proposal.

C. Small Entities Subject to the Rule

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.[72] Approximately 159 registered investment companies meet this definition.[73] Approximately 38 business

[72] Rule 0-10(a) under the Investment Company Act [17 CFR 240.0-10(a)].

[73] The estimated number of reporting investment companies that may be considered small entities is based on December 2007 data from the Commission's EDGAR database and a third-party data provider.

development companies may be considered small entities.[74] We estimate that few, if any, separate accounts registered on Form N-3, N-4, or N-6 are small entities.[75]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The amendments require applicants to submit requests for orders and small business investment companies and business development companies to submit Regulation E filings electronically on the EDGAR system. The Commission estimates some one-time formatting and ongoing burdens that will be imposed on all applicants and Regulation E filers, including those that are small entities. We note, however, that all Regulations E filers and most applicants currently make other filings on EDGAR. Furthermore, we believe that non-investment company applicants will have no greater burden than that of those filers of Section 16 reports or Schedules 13D and 13G[76] who will not otherwise make EDGAR filings and that the electronic submission should create only a de minimis burden.

There will be no change in reporting or recordkeeping requirements. The amendments to Rule 0-2 reduce compliance requirements to the extent that they will remove the requirements for notarization of the application and provision of a draft notice with the application.

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[74] This estimate is based on analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers.

[75] This estimate is based on figures compiled by the Division of Investment Management staff regarding separate accounts registered on Forms N-3, N-4, and N-6. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Rule 0-10(b) under the Investment Company Act [17 CFR 270.0-10(b)].

[76] 17 CFR 240.13d-101 and 240.13d-102.

We solicited comment on the effect the amendments would have on small entities. We received no comments in response.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that will accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, is not appropriate or consistent with investor protection. Different requirements for applicants or Regulation E filers that are small entities could make it more difficult for the public to locate Commission filings and disclosure documents for these applicants. We believe it is important that the benefits resulting from the amendments be provided to the public for all applications and Regulation E filings, not just for applications and Regulation E filings for entities that are not considered small entities.

We have endeavored throughout the amendments to minimize the regulatory burden on all applicants and Regulation E filers, including small entities, while meeting our regulatory objectives. Small entities should benefit from the Commission's reasoned approach to the amendments to the same degree as others. The Commission believes that further clarification, consolidation, or simplification of the amendments for those that are small entities would be inconsistent with the Commission's concern for investor protection. Further clarification, consolidation, or simplification of the amendments for those that are small entities would result in less information available about them. Similarly, we conclude that using performance rather than design standards would not be consistent with our statutory mandate of investor protection. We believe that the standard provided in the amendments (EDGAR filing) is already sufficiently clear and appropriately simple. A major goal of making these mandatory EDGAR submissions is a more complete and searchable EDGAR database of filings; we do not believe that there is a comparable performance standard that will achieve this goal.

IX. PAPERWORK REDUCTION ACT

The rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[77] We submitted the collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. 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 control number.

A. Rule 0-2

The title for the collection of information is "General Requirements of Papers and Applications." OMB approved this collection of information under control number 3235-0636 (expiring on February 28, 2011). Provision of information under the rule is necessary to obtain a

[77] 44 U.S.C. 3501 *et seq.*

benefit. The information is not kept confidential. Respondents to the collection are applying for orders of the Commission under the Investment Company Act. The Commission uses the information required by Rule 0-2 to decide whether the applicant should be deemed to be entitled to the action requested by the application. The amendments to Rule 0-2 eliminate the requirement to have verifications of applications and statements of facts made in connection with applications notarized[78] and eliminate the requirement that applicants include draft notices as exhibits to applications.[79]

Burden Estimate for Rule 0-2

Applicants file applications as they deem necessary. The Commission receives approximately 125 applications per year under the Investment Company Act. Although each application typically is submitted on behalf of multiple entities, the entities in the vast majority of cases are related companies and are treated as a single applicant for purposes of this analysis.

Much of the work of preparing an application is performed by outside counsel. The cost outside counsel charges applicants depends on the complexity of the issues covered by the application and the time required for preparation. Based on conversations with applicants and attorneys, the cost ranges from approximately $7,000 for preparing a well-precedented, routine application to approximately $80,000 to prepare a complex and/or novel application. We estimate that the Commission receives 20 of the most time-consuming applications annually, 80 applications of medium difficulty, and 25 of the least difficult applications. This distribution

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78 See Rule 0-2(d).

79 See Rule 0-2(g).

gives a total estimated annual cost burden to applicants of filing all applications of $5,255,000 [(20x$80,000) + (80x$43,500) + (25x$7,000)].

In addition, based on conversations with applicants, we estimate that in-house counsel spend from ten to fifty hours helping to draft and review an application. We estimate a total annual hour burden to all respondents of 3,650 hours (50 hours x 20 applications) + (30 hours x 80 applications) + (10 hours x 25 applications).

We have decreased the burden associated with the existing collection of information for Rule 0-2 to reflect the amendments. The amendments to Rule 0-2 eliminate the requirement to have verifications of applications and statements of facts made in connection with applications notarized. The notary service was provided by a secretary or similar administrative employee of the applicant or the outside counsel preparing the application and represented a negligible cost or hour burden to the applicant, so elimination of the notarization requirement will not be likely to decrease the burden measurably.

The amendments also eliminate the requirement that applicants include proposed notices as exhibits to applications. A proposed notice is merely a summary of the statements in the application. We estimate that preparation of the proposed notice by outside counsel represents approximately 1% of the cost of preparing an application. Elimination of this requirement will reduce the estimated cost burden by approximately $52,550 (1% of $5,255,000). The amendments will not change the hour burden.

We estimate the total reduction in the burden will be approximately $52,550.

B. Regulation S-T

The title for the collection of information is "General Rules and Regulations for

Electronic Filing." (OMB Control No. 3235-0424, expiring on September 30, 2008). The purpose of Regulation S-T is to implement the Commission's EDGAR system. The EDGAR system enables the Commission to receive, store, process and disseminate information filed with the Commission under the provisions of the federal securities laws. The Commission's forms and rules require filings that make information available to the investing public and that permit the Commission to verify compliance with the federal securities laws. Electronic filing improves the availability to the public and to the Commission of information filed with the Commission. Regulation S-T specifies the requirements that govern the electronic submission of documents to the Commission. Provision of the information required by the Regulation is mandatory. Responses are not kept confidential.

Burden Estimate for Regulation S-T

The amendments to Regulation S-T revise Rule 101 under Regulation S-T to require electronic filing of applications for orders of the Commission under the Investment Company Act and of forms required by Regulation E under the Securities Act of 1933. The burden associated with the filing of applications under Rule 0-2 is reflected in the collection of information entitled "General Requirements of Papers and Applications." We are not amending Regulation E. The burden associated with the filing of documents required by Regulation E is reflected in the collections of information required by Regulation E, and will not change as a result of the amendments to Regulation S-T. We are also amending Rule 201 under Regulation S-T, which governs temporary hardship exemptions from electronic filing. Rule 201 is part of Regulation S-T and does not impose any burden on respondents separate from Regulation S-T. The amendments to Rule 201 will not change the burden of Regulation S-T. The Paperwork

Reduction Act requires that we obtain OMB approval for a collection of information, whether the collection has a burden or not. Regulation S-T is a collection of information with no burden to respondents. OMB requires us to assign a burden of one hour to Regulation S-T and to indicate that the Regulation has one respondent so the automated OMB system will be able to handle approval of the Regulation. OMB has already approved a burden of one hour for one respondent to the Regulation.

C. Form ID

The Commission estimates that each year a small number of applicants for orders under the Investment Company Act will need to file a Form ID (OMB Control Number 3235-0328, expiring April 30, 2009) with the Commission in order to gain access to EDGAR. Form ID is used to request the assignment of access codes to file on EDGAR. Most applicants will not need to file a Form ID because any applicant that has made at least one filing with the Commission since 2002 has been entered into the EDGAR system by the Commission and will not need to file Form ID to file electronically on EDGAR. However, applicants that have never made a filing with the Commission will need to file Form ID.

The Commission estimates that it will receive approximately 10 Forms ID a year under the amendments. Because the actual number of Forms ID the Commission receives each year is less than the current estimate, we are not revising the estimated number of respondents that file a Form ID.

We received no comments on the PRA section of the proposal.

X. STATUTORY BASIS

We adopt the rule amendments outlined above under Sections 6, 7, 8, 10 and 19(a) of the Securities Act [15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a)], Sections 3, 12, 13, 14, 15(d), 23(a) and 35A of the Exchange Act [15 U.S.C. 78c, 78l, 78m, 78n, 78o(d), 78w(a), and 78ll], and Sections 8, 30, 31 and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37].

List of Subjects

17 CFR Part 232

Reporting and recordkeeping requirements, Securities.

17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities..

TEXT OF THE RULE AMENDMENTS

In accordance with the foregoing, the Commission amends Title 17, Chapter II of the Code of Federal Regulations as follows.

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll (d), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

2. Section 232.101 is amended by:

a. Revising paragraphs (a)(1)(iv) and (v), the introductory text of paragraph (a)(2), paragraph (a)(2)(i), the first sentence of paragraph (a)(3);

b. Removing "and Regulation E (§§230.601 - 230.610a of this chapter)" from paragraph (c)(6); and

c. Removing and reserving paragraph (c)(11).

The revisions read as follows:

§232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(iv) Documents filed with the Commission pursuant to sections 8, 17, 20, 23(c), 24(b), 24(e), 24(f), and 30 of the Investment Company Act (15 U.S.C. 80a-8, 80a-17, 80a-20, 80a-23(c), 80a-24(b), 80a-24(e), 80a-24(f), and 80a-29) and any application for an order under any section of the Investment Company Act (15 U.S. C. 80a-1 et seq.);

(v) Documents relating to offerings exempt from registration under the Securities Act filed with the Commission pursuant to Regulation E (§§230.601 - 230.610a of this chapter);

* * * * *

(2) The following amendments to filings and applications, including any related correspondence and supplemental information except as otherwise provided, shall be submitted as follows:

(i) Any amendment to a filing or application submitted by or relating to a registrant or an applicant that is required to file electronically, including any amendment to a paper filing or application, shall be submitted in electronic format;

* * * * *

(3) Supplemental information, including documents related to applications under any

section of the Investment Company Act, shall be submitted in electronic format except as provided in paragraph (c)(2) of this section. * * *

* * * * *

3. Amend §232.201 by revising paragraph (a) introductory text to read as follows:

§232.201 Temporary hardship exemption.

(a) If an electronic filer experiences unanticipated technical difficulties preventing the timely preparation and submission of an electronic filing other than a Form 3 (§249.103 of this chapter), a Form 4 (§249.104 of this chapter), a Form 5 (§249.105 of this chapter), a Form ID (§§239.63, 249.446, 269.7 and 274.402 of this chapter), a Form TA–1 (§249.100 of this chapter), a Form TA–2 (§249.102 of this chapter), a Form TA–W (§249.101 of this chapter), a Form D (§239.500 of this chapter), or an application for an order under any section of the Investment Company Act (15 U.S.C. 80a–1 et seq.), the electronic filer may file the subject filing, under cover of Form TH (§§239.65, 249.447, 269.10 and 274.404 of this chapter), in paper format no later than one business day after the date on which the filing was to be made.

* * * * *

PART 270 -- RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

4. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

* * * * *

Commissioner Aguilar and
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58882/October 30, 2008

INVESTMENT COMPANY ACT OF 1940
Release No. 28477/October 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13283

In the Matter of **ROBERT A. WARD,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) and 21C OF THE SECURITIES EXCHANGE ACT OF 1934 and SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO ROBERT A. WARD**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Robert A. Ward ("Ward" or "Respondent").

II.

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

Securities Exchange Act of 1934 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to Robert A. Ward ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Respondent

1. **Robert A. Ward** ("Ward"), age 47, resides in New York, New York and has been a licensed securities professional since 1983. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets LLC as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

Other Relevant Parties

2. **Lazard Capital Markets LLC** ("Lazard Capital Markets") is registered with the Commission as a broker-dealer (File No. 8-2595) pursuant to Section 15(b) of the Exchange Act, with its principal place of business in New York, New York. Lazard Freres & Co. LLC's capital markets assets were separated from its other businesses and transferred to Lazard Capital Markets in 2005.[2] At all relevant times, Lazard Freres & Co. LLC was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and provided securities brokerage services to institutional customers.

3. **Louis Gregory Rice** ("Rice"), age 42, resides in New York, New York and has been a licensed securities professional since 1987. From 1987 until he resigned in March 2005, Rice held various positions with Lazard Capital Markets. He became a managing director in 1996 and from 1996 to 2005, was the head of Lazard Capital Markets' equity sales and trading department in the United States, supervising, among others, Ward.

4. **FMR Co., Inc.** ("Fidelity") is registered with the Commission as an investment adviser (File No. 801-3447) pursuant to Section 203(c) of the Investment Advisers Act of 1940 ("Advisers Act"), with its principal place of business in Boston, Massachusetts. Fidelity is a wholly owned subsidiary of Fidelity Management & Research Company ("FMR"), which is also an investment adviser registered with the Commission (File No. 801-7884) pursuant to Section 203(c) of the Advisers Act. Fidelity provides portfolio management services as a sub-adviser to certain customers of FMR, including approximately 350 registered investment companies

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

[2] For purposes of this Order, unless otherwise described, the term "Lazard Capital Markets" includes its predecessor entity, Lazard Freres & Co., LLC.

marketed under the "Fidelity Investments" trade name and managed by FMR and its affiliates (the "Fidelity Funds").[3]

5. **Thomas H. Bruderman** ("Bruderman"), age 39, lives in Boston, Massachusetts. He was a domestic equity trader at Fidelity from 1998 until December 2004.[4]

Facts

Summary

6. These proceedings concern Ward's provision of extensive travel, entertainment and gifts to Fidelity equity trader Thomas H. Bruderman and certain other members of Fidelity's equity trading desk. The members of Fidelity's equity trading desk who received such travel, entertainment and gifts included equity securities traders, whose responsibilities included directing securities transactions for the Fidelity Funds to securities brokerage firms for execution.

7. From 2000 through 2004 (the "Relevant Period"), in an effort to generate brokerage business, Ward expensed to Lazard Capital Markets over $200,000 in connection with taking Bruderman and certain other Fidelity traders on trips to exotic locations, lodging them at fancy hotels, and providing them with tickets to concerts and gifts such as expensive wine.[5] In addition, in connection with certain of these entertainment events, Ward provided Bruderman and a few other Fidelity traders with the drug commonly referred to as "ecstasy."

8. Lazard Capital Markets received substantial business from Fidelity traders during the period that Ward and certain other Lazard Capital Markets employees provided travel, entertainment and gifts to Fidelity traders. Throughout the Relevant Period, the brokerage commissions Ward, together with certain other Lazard Capital Markets employees, generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. For example, from 2001 to 2003, Fidelity commissions generated by Fidelity traders to whom Ward and certain other Lazard Capital Markets employees provided travel, entertainment and gifts constituted an average of over 16% of Lazard Capital Markets' annual commission revenue during

[3] On March 5, 2008, the Commission instituted a related administrative proceeding against Fidelity. *See In the Matter of Fidelity Management & Research Co. and FMR Co. Inc.*, Advisers Act Release No. 2713, Admin. Proc. File No. 3-19276 (March 5, 2008).

[4] On March 5, 2008, the Commission instituted a related administrative proceeding against Bruderman and nine other employees of Fidelity's equity trading desk. *See In the Matter of Scott DeSano, et al.*, Admin. Proc. File No. 3-12978 (March 5, 2008).

[5] Simultaneously with the commencement of this proceeding, the Commission has issued Orders with respect to Lazard Capital Markets and Messrs. Rice, David L. Tashjian and W. Daniel Williams. *See* the following Commission Orders: *In the Matter of Lazard Capital Markets LLC*, Admin. Proc. File No. 3-13281 (October 30, 2008); *In the Matter of Louis Gregory Rice*, Admin. Proc. File No. 3-13282 (October 30, 2008); *In the Matter of David L. Tashjian*, Admin. Proc. File No. 3-13284 (October 30, 2008); and *In the Matter of W. Daniel Williams*, Admin. Proc. File No. 3-13285 (October 30, 2008).

that period. During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

9. Bruderman was the primary recipient of Ward's gifts and lavish entertainment of Fidelity traders. During the Relevant Period, Ward expensed over $120,000 in connection with entertaining and providing gifts and travel to Bruderman. During the same period, Bruderman (who also received travel, entertainment and gifts from other Lazard Capital Markets employees) personally directed Fidelity securities orders to Ward that generated a total of approximately $21.6 million in commissions for Lazard Capital Markets, over ten percent of Lazard Capital Markets' total commission revenue during that five-year period.

10. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. Bruderman and the other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of registered investment companies (the Fidelity Funds), because Fidelity is the adviser to those funds. Bruderman's and the other Fidelity traders' receipt of travel, entertainment and gifts from Ward constituted compensation within the prohibition of Section 17(e)(1) of the Investment Company Act.

11. As a result of his conduct, Ward aided and abetted and caused Bruderman's and certain other Fidelity traders' violations of Section 17(e)(1) of the Investment Company Act.

<u>Background</u>

12. Prior to joining Lazard Capital Markets, while working as a sales trader for a competitor broker-dealer, Ward had developed business relationships with certain Fidelity equity traders. In or about 1998, Rice, the head of Lazard Capital Markets' equity sales and trading department, hired Ward and some of his colleagues in an effort to increase the department's brokerage business. Ward was given access to a travel and entertainment budget, which he was able to access through a Lazard Capital Markets-issued credit card. As required, Ward routinely submitted his expenses for approval by Lazard Capital Markets.

13. Lazard Capital Markets' policies prohibited providing gifts in excess of $100. From 2001 through at least mid-2004, Lazard Capital Markets' Compliance Manual stated:

> An employee may not give any gratuity in excess of $100 per person per year to any principal, officer, or employee of another ... *financial institution....* Records shall be retained for at least three years of all such gratuities and compensation for inspection by Exchange examiners. (emphasis added).

Lazard Capital Markets also subjected its managing directors and employees to the prerequisites of relevant law and reasonable conduct and required that:

Any questions regarding the application or interpretation of behavior or conduct that may be acceptable must be brought to the attention of the General Counsel or his designee *before* any action is taken. (emphasis added).

Ward's Lavish Entertainment of Certain Fidelity Employees

14. During the Relevant Period, Ward expensed to Lazard Capital Markets over $200,000 in connection with entertaining and providing gifts and travel to Bruderman and a few other Fidelity employees. The travel, entertainment and gifts consisted of trips including air travel, luxury accommodations, meals and other entertainment; expensive gifts such as a $1,300 case of wine and $1,329 humidor; and numerous tickets to concerts and the theater. During some of these trips and events, Ward provided drugs, including "ecstasy," to Bruderman and certain other Fidelity traders.

15. Examples of the trips that Ward (in some instances along with certain other Lazard Capital Markets employees) provided are as follows:

a. During 2001, Ward, together with other Lazard Capital Markets employees, took Bruderman on several out-of-town trips, including four trips to Florida (during which Ward expensed approximately $36,000, and that cost Lazard Capital Markets in total over $68,000), an excursion to California (during which Ward expensed approximately $2,900, and that cost Lazard Capital Markets in total over $76,000), and a trip to Europe (for which Ward expensed costs to Lazard Capital Markets of over $13,000 for Bruderman and a number of other guests).

b. In January 2002, Ward took Bruderman to Florida for four days. Ward provided lodging, dinners and greens fees at a golf club, along with $4,000 at an adult entertainment club called Rachael's Steakhouse. During that trip, Ward also paid over $5,390 to take Bruderman and a colleague for lessons at a local auto racing school. The total cost to Lazard Capital Markets for the trip was over $15,000, nearly all of which Ward expensed.

c. In or about August 2002 and again in or about August 2003, Ward, together with other Lazard Capital Markets employees, took certain clients, including at least one Fidelity trader, on trips to the Red Tail Golf Club, near Toronto, Canada. Ward, who was a member, provided the food, lodging, and golf, and the participants traveled by private jet at Lazard Capital Markets' expense. The total cost to Lazard Capital Markets for this trip was over $34,000 in 2002 and $43,000 in 2003.

d. In February 2003, Ward took a Fidelity trader, Bruderman, and Bruderman's guest, to Napa, California for a wine country excursion. Ward provided several nights lodging at high end hotels and meals at exclusive restaurants (including a $3,600 dinner at the French Laundry). The total cost to Lazard Capital Markets for this trip was over $16,000, nearly all of which Ward expensed.

e. In or about March 2003, Ward, together with other Lazard Capital Markets employees, joined with representatives of other brokerage firms to pay for Bruderman's bachelor party in Miami. Ward and the other Lazard Capital Markets employees provided several rooms at the Delano hotel, including a $3,000 per night suite. Ward expensed over $10,000 on this trip, which cost Lazard Capital Markets in total over $50,000.

Lazard Capital Markets Received Substantial Business from Fidelity During the Period Ward Provided Travel, Entertainment and Gifts to Fidelity Certain Traders

16. During the Relevant Period, Ward used travel, entertainment and gifts in a manner that violated Lazard Capital Markets' policies requiring that entertainment be reasonable, based on the nature, scale and frequency of the entertainment targeted toward Bruderman.

17. Throughout the Relevant Period, the brokerage commissions Ward generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. In addition, the commissions Lazard Capital Markets received from the Fidelity Funds grew after Ward joined Lazard Capital Markets. In 1998, the year Lazard Capital Markets hired Ward and his colleagues, Lazard Capital Markets received $1.4 million in commissions from Fidelity. By contrast, during the 2001 to 2003 period, for example, Ward was responsible for generating the following commissions from Fidelity, representing the following percentages of Lazard Capital Markets' overall gross commission revenue:

Year	Approximate Gross Commission Revenue Ward Generated From Fidelity	Approximate Percentage of Lazard Capital Markets' Overall Commission Revenue
2001	$7.4 million	16.2%
2002	$7.2 million	16.4%
2003	$6.1 million	16.1%

During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

18. Bruderman, the primary beneficiary of Ward's largesse, alone sent trades generating a total of $21.6 million in brokerage commissions to Lazard Capital Markets during the Relevant Period, as follows:

2000	$3.6 million
2001	$6.4 million
2002	$5.6 million
2003	$3.8 million
2004	$2.2 million

The commissions generated from Bruderman represented over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

19. The travel, entertainment and gifts Ward provided to Bruderman and a few other Fidelity traders constituted prohibited "compensation" within the scope of Section 17(e)(1) of the Investment Company Act.

Violations of the Federal Securities Laws

20. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. A violation of Section 17(e)(1) is complete upon receipt of the compensation. Bruderman and certain other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of investment companies (the Fidelity Funds), because Fidelity advises those funds. Bruderman and certain other Fidelity traders' receipt of travel, entertainment and gifts from Ward constituted compensation in violation of Section 17(e)(1) of the Investment Company Act. As a result of the conduct above, Ward willfully aided and abetted and caused those violations.

Undertakings

21. Respondent Ward shall provide the Commission, within 10 days after the end of the 6-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

22. In determining whether to accept the Offer, the Commission considered these undertakings.

IV.

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

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

A. Respondent Ward cease and desist from committing or causing any violations and any future violations of Section 17(e)(1) of the Investment Company Act.

B. Respondent Ward be, and hereby is suspended from association with any broker or dealer for a period of six months, effective on the second Monday following the entry of this Order.

C. Respondent Ward be, and hereby 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 for a period of six months, effective on the second Monday following the entry of this Order.

D. IT IS FURTHER ORDERED that Respondent shall pay a civil money penalty in the amount of $50,000.00 to the United States Treasury in accordance with the following schedule: (1) $25,000 within 10 days of entry of this Order, and (2) $25,000 within 364 days of entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire balance of the civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. 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 cover letter that identifies Robert A. Ward 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 David P. Bergers, Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110-1424.

E. Respondent Ward shall comply with the undertakings enumerated in paragraph 21, above.

By the Commission.

Florence E. Harmon
Acting Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Aguilar and Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58880/October 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13281

In the Matter of **LAZARD CAPITAL MARKETS LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS, PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AS TO LAZARD CAPITAL MARKETS LLC**

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 Lazard Capital Markets LLC ("Lazard Capital Markets" or "Respondent").

II.

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

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Respondent

1. **Lazard Capital Markets** is registered with the Commission as a broker-dealer (File No. 8-2595) pursuant to Section 15(b) of the Exchange Act, with its principal place of business in New York, New York. Lazard Freres & Co. LLC 's capital markets assets were separated from its other businesses and transferred to Lazard Capital Markets in 2005.[2] At all relevant times, Lazard Freres & Co. LLC was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and provided securities brokerage services to institutional customers.

Other Relevant Parties

2. **David L. Tashjian** ("Tashjian"), age 52, resides in New York, New York and has been a licensed securities professional since 1982. From 1992 until 2006, when he resigned, Tashjian held various senior positions with Lazard Capital Markets, becoming a managing director in 1993 and, for a period of time, serving on the firm's management committee. In 2002, Tashjian became the head of Lazard Capital Markets' U.S. sales and trading department, in which two Lazard Capital Markets registered representatives within his supervisory authority, Robert A. Ward and W. Daniel Williams, were employed. In 2005, he became head of Lazard Capital Markets' equity sales and trading department.

3. **Louis Gregory Rice** ("Rice"), age 42, resides in New York, New York and has been a licensed securities professional since 1987. From 1987 until he resigned in March 2005, Rice held various positions with Lazard Capital Markets. He became a managing director in 1996 and from 1996 to 2005, was the head of Lazard Capital Markets' equity sales and trading department in the United States, supervising, among others, Robert A. Ward and W. Daniel Williams and reporting to Tashjian.

4. **Robert A. Ward** ("Ward"), age 47, resides in New York, New York and has been a licensed securities professional since 1983. From April 1998 until he was permitted to resign in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

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

[2] For purposes of this Order, unless otherwise described, the term "Lazard Capital Markets" includes its predecessor entity, Lazard Freres & Co., LLC.

5. **W. Daniel Williams** ("Williams"), age 47, resides in Westport, Connecticut and has been a licensed securities professional since 1985. From April 1998 until he was permitted to resign in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

6. **FMR Co., Inc.** ("Fidelity") is registered with the Commission as an investment adviser (File No. 801-3447) pursuant to Section 203(c) of the Investment Advisers Act of 1940 ("Advisers Act"), with its principal place of business in Boston, Massachusetts. Fidelity is a wholly owned subsidiary of Fidelity Management & Research Company ("FMR"), which is also an investment adviser registered with the Commission (File No. 801-7884) pursuant to Section 203(c) of the Advisers Act. Fidelity provides portfolio management services as a sub-adviser to certain customers of FMR, including approximately 350 registered investment companies marketed under the "Fidelity Investments" trade name and managed by FMR and its affiliates (the "Fidelity Funds").[3]

7. **Thomas H. Bruderman** ("Bruderman"), age 39, lives in Boston, Massachusetts. He was a domestic equity trader at Fidelity from 1998 until December 2004.[4]

Facts

Summary

8. These proceedings concern Lazard Capital Markets' provision of travel, entertainment and gifts to certain employees of Fidelity. From 2000 to 2004 (the "Relevant Period"), two Lazard Capital Markets registered representatives, Ward and Williams, and Tashjian, who headed Lazard Capital Markets' U.S. sales and trading department, used a total of over $600,000 in connection with entertaining and providing travel and gifts, much of which violated Lazard Capital Markets' policies, to Fidelity equity trader Thomas H. Bruderman and certain other members of Fidelity's equity trading desk. Bruderman and the other Fidelity equity traders who received such travel, entertainment and gifts were responsible for selecting brokerage firms to execute orders to buy and sell securities for the Fidelity Funds. Lazard Capital Markets employees took Bruderman on trips to Europe, the Bahamas, the Caribbean, Florida, and Napa Valley, California, often by private plane, including meals and lodging at high-end restaurants and hotels; and provided Bruderman race car driving lessons, adult entertainment and expensive

[3] On March 5, 2008, the Commission instituted a related administrative proceeding against Fidelity. *See In the Matter of Fidelity Management & Research Co. and FMR Co. Inc.*, Advisers Act Release No. 2713, Admin. Proc. File No. 3-19276 (March 5, 2008).

[4] On March 5, 2008, the Commission instituted a related administrative proceeding against Bruderman and nine other employees of Fidelity's equity trading desk. *See In the Matter of Scott DeSano, et al.*, Admin. Proc. File No. 3-12978 (March 5, 2008).

wine. In addition, Lazard Capital Markets employees contributed approximately $50,000 to the expenses associated with Bruderman's elaborate bachelor party in Miami. [5]

9. Throughout the Relevant Period, the brokerage commissions Ward and Williams generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. For example, from 2001 to 2003, Fidelity commissions generated by Fidelity traders to whom Tashjian, Ward and Williams provided travel, entertainment and gifts constituted an average of over 16% of Lazard Capital Markets' annual commission revenue during that period. During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

10. During the Relevant Period, Bruderman personally directed Fidelity securities orders to Ward and Williams that generated approximately $21.6 million in commissions - over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

11. Section 17(e)(1) of the Investment Company Act of 1940 ("Investment Company Act") makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. Bruderman and the other Fidelity employees were affiliated persons of Fidelity, which is an affiliated person of registered investment companies (the Fidelity Funds), because Fidelity is the adviser to those funds. Bruderman's and the other Fidelity traders' receipt of travel, entertainment and gifts from Lazard Capital Markets employees constituted compensation within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

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[5] Simultaneously with the commencement of this proceeding, the Commission has issued Orders with respect to Messrs. Tashjian, Rice, Ward and Williams. *See* the following Commission Orders: *In the Matter of David L. Tashjian*, Admin. Proc. File No. 3-13284 (October 30, 2008); *In the Matter of Louis Gregory Rice*, Admin. Proc. File No. 3-13282 (October 30, 2008); *In the Matter of Robert A. Ward*, Admin. Proc. File No. 3-13283 (October 30, 2008); and *In the Matter of W. Daniel Williams*, Admin. Proc. File No. 3-13285 (October 30, 2008).

12. Section 15(b)(4) of the Exchange Act authorizes the Commission to censure and impose civil penalties on a broker or dealer for failing reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such a violation, if that person is subject to the broker's or dealer's supervision.

13. Lazard Capital Markets failed reasonably to supervise, within the meaning of Section 15(b)(4)(E) of the Exchange Act, Tashjian, Ward, and Williams, with a view to preventing their aiding and abetting and causing Bruderman's and, in several instances, other Fidelity traders' violations of Section 17(e)(1) of the Investment Company Act.

Lazard Capital Markets' Policies

14. Lazard Capital Markets' policies prohibited providing gifts in excess of $100. From 2001 through at least mid-2004, Lazard Capital Markets' Compliance Manual stated:

> An employee may not give any gratuity in excess of $100 per person per year to any principal, officer, or employee of another ... *financial institution*.... Records shall be retained for at least three years of all such gratuities and compensation for inspection by Exchange examiners. (emphasis added).

Lazard Capital Markets also subjected its managing directors and employees to the prerequisites of relevant law and reasonable conduct and required that:

> Any questions regarding the application or interpretation of behavior or conduct that may be acceptable must be brought to the attention of the General Counsel or his designee *before* any action is taken. (emphasis added).

15. Lazard Capital Markets' General Supervision manual made it clear that supervisors were responsible for ensuring employee compliance with its gifts and entertainment policies. Under the heading "Conflicts of Interest," the manual provided that:

> Supervisory Personnel are responsible for being familiar with these [gifts and gratuities] rules, and they must make certain that the employees under their supervision fully comply with them. Any doubts or concerns regarding the propriety of a gift or gratuity should be brought to the attention of the Legal and Compliance Department.

16. Under the heading "Entertainment of Customers," Lazard Capital Markets' General Supervision Manual stated:

> Firm policy provides that a Managing Director must approve all entertainment expenditures and document their approval in writing on the appropriate forms.... If a Supervisor confronts a compliance problem concerning the entertainment of customers, he should immediately contact the Legal and Compliance Department to plan an appropriate response.

<u>NASD Conduct Rule 3060</u>

17. NASD Conduct Rule 3060, which was in effect during the Relevant Period, prohibited an NASD member, such as Lazard Capital Markets, or persons associated with a member, such as Lazard Capital Markets' employees, from providing a gift or gratuity:

> in excess of one hundred dollars per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity."[6]

18. The NASD staff's published guidance concerning Rule 3060's application to business entertainment, also in effect during the Relevant Period, stated:

> when a member or its associated persons are hosting clients and their guests at *an occasional meal, sporting event, theater production or comparable entertainment event*, the [NASD] staff would not regard such business entertainment as governed by Rule 3060 *so long as it is neither so frequent nor so extensive as to raise any question of propriety.*" (emphasis added).[7]

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[6] NASD Conduct Rule 3060.

[7] June 10, 1999 letter from NASD staff to T. Rowe Price Investment Services, Inc., located at: http://www.finra.org/web/idcplg?IdcService=SS_GET_PAGE&siteId=5&siteRelativeUrl=%2FRulesRegulation%2FPublicationsGuidance%2FInterpretiveLetters%2FConductRules%2FP002715&ssUrlPrefix=/&PrinterFriendly=1

Tashjian, Ward and Williams Aided and Abetted and Caused Bruderman's and Certain Other Fidelity Traders' Violations of Section 17(e)(1) of the Investment Company Act

19. During the Relevant Period, Tashjian expensed to Lazard Capital Markets over $350,000, Ward expensed over $200,000, and Williams expensed over $100,000 in connection with entertaining and providing travel and gifts primarily to Bruderman and, on several occasions, to certain other members of Fidelity's equity trading desk.

20. From 2001 through 2004, Tashjian provided Bruderman certain gifts and took him on ten out-of-town trips. For example, Tashjian attended lavish trips to California and Miami with Rice, Ward and Williams during which Lazard Capital Markets employees provided to Bruderman air travel, luxury hotel accommodations, meals, boat rentals, golf, and/or car services. Lazard Capital Markets reimbursed its employees a total of $50,000 in connection with their attendance and entertainment of Bruderman at his 2003 bachelor party in Miami, including paying for hotel rooms, adult entertainment, car services, and golf for Bruderman and/or his guests. In addition, Lazard Capital Markets paid for two trips in which Tashjian and Ward took Bruderman and his fiancé to the Bahamas, including providing them both private air travel, exclusive hotel accommodations, and meals. Lazard Capital Markets paid for Tashjian to take Bruderman and his significant other on three additional trips in the Caribbean.

21. During the Relevant Period, Ward took Bruderman on several out-of-town trips. For example, Lazard Capital Markets paid over $16,000 for Ward to take Bruderman and his fiancé on a trip to Napa, California, providing meals and lodging. Lazard Capital Markets also paid for Ward to take Bruderman on a trip to Florida, providing airfare, lodging and meals. On that trip, Ward expensed to Lazard Capital Markets Bruderman's attendance at an auto racing school. Ward also provided at least several expensive gifts to Bruderman and certain other Fidelity traders, including providing to Bruderman a case of wine and a humidor, each of which cost Lazard Capital Markets over $1,000.

22. Williams also took Bruderman on several trips. For example, he expensed to Lazard Capital Markets a trip to Las Vegas, Nevada and Mexico, on which he and certain other broker representatives provided Bruderman and three other Fidelity trading desk employees golf outings, lodging and entertainment.

23. Tashjian accompanied Ward and Williams on certain trips on which Lazard Capital Markets employees provided Bruderman travel and entertainment that failed to comply with Lazard Capital Markets' policies, and applicable rules and regulations.

24. Rice actively encouraged Ward and Williams to use Lazard Capital Markets' expense account to provide travel and entertainment to Bruderman and several other Fidelity traders, in an

effort to generate brokerage business for Lazard Capital Markets. During much of the Relevant Period, Rice reviewed and approved each of Ward's and Williams's travel and entertainment expenses and approved certain extravagant events that were not in compliance with Lazard Capital Markets' policies, and applicable rules and regulations.

25. The travel, entertainment and gifts provided to Bruderman by Lazard Capital Markets employees constituted prohibited "compensation" within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

Lazard Capital Markets Received Substantial Business from Fidelity During the Period its <u>Employees Provided Travel, Entertainment and Gifts to Certain Fidelity Traders</u>

26. During the Relevant Period, Tashjian, Ward and Williams used travel, entertainment and gifts in a manner that violated Lazard Capital Markets' policies requiring that entertainment be reasonable, based on the nature, scale and frequency of the entertainment targeted toward Bruderman.

27. Throughout the Relevant Period, the brokerage commissions Lazard Capital Markets generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. In addition, the commissions Lazard Capital Markets received from the Fidelity Funds grew after Ward and Williams joined Lazard Capital Markets. In 1998, the year Lazard Capital Markets hired Ward and Williams, Lazard Capital Markets received $1.4 million in commissions from Fidelity. By contrast, during the 2001 to 2003 period, for example, Ward and Williams were responsible for generating the following commissions from Fidelity, representing the following percentages of Lazard Capital Markets' overall gross commission revenue:

Year	Approximate Gross Commission Revenue Ward and Williams Generated From Fidelity	Approximate Percentage of Lazard Capital Markets' Overall Commission Revenue
2001	$7.4 million	16.2%
2002	$7.2 million	16.4%
2003	$6.1 million	16.1%

During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

28. Bruderman, the primary beneficiary of travel, entertainment and gifts from employees of Lazard Capital Markets, alone sent trades generating a total of $21.6 million in brokerage commissions to Lazard Capital Markets during the Relevant Period, as follows:

2000	$3.6 million
2001	$6.4 million
2002	$5.6 million
2003	$3.8 million
2004	$2.2 million

The commissions generated from Bruderman represented over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

Lazard Capital Markets Failed to Supervise Tashjian, Ward, and Williams

29. Lazard Capital Markets failed reasonably to implement its policies with respect to supervisory review of its employees' provision of travel, entertainment and gifts. Moreover, Lazard Capital Markets did not have reasonable procedures for monitoring the nature and extent of Tashjian's, Ward's and Williams' provision of travel, entertainment and gifts to Bruderman and other Fidelity traders. Expense reports for Tashjian, Ward and Williams generally were reviewed only to ensure proper documentation of the expenses. However, Lazard Capital Markets supervisors generally did not review Tashjian's, Ward's and Williams' provision of travel, entertainment and gifts to Fidelity traders for compliance with applicable policies, rules, and regulations.

30. If Lazard Capital Markets had reasonably implemented its existing policies to oversee Tashjian's, Ward's and Williams' provision of travel, entertainment and gifts to Bruderman and other Fidelity traders, it is likely Lazard Capital Markets could have prevented and detected Tashjian's, Ward's and Williams' securities law violations.

Violations of the Federal Securities Laws

31. As a result of the conduct described above, Lazard Capital Markets failed reasonably to supervise Tashjian, Ward and Williams, with a view to preventing their aiding and abetting and causing of Bruderman's and certain other Fidelity's traders' violations of Section 17(e)(1) of the Investment Company Act, within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Lazard Capital Markets' Cooperation

32. In determining to accept Lazard Capital Markets' Offer, the Commission considered the extraordinary 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 Lazard Capital Markets' Offer.

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

A. Respondent Lazard Capital Markets is hereby censured; and

B. IT IS FURTHER ORDERED THAT Respondent Lazard Capital Markets shall, within 10 days of the entry of this Order, pay disgorgement of $1,817,629 and prejudgment interest of $429,379.04, and a civil monetary penalty of $600,000, to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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 Lazard Capital Markets 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 David P. Bergers, Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110-1424.

By the Commission.

Florence E. Harmon
Acting Secretary

J Lynn Taylor

By J. Lynn Taylor
Assistant Secretary

Commissioner Walter
not participating

SECURITIES AND EXCHANGE COMMISSION

[Release No. IA-2806]

Approval of Investment Adviser Registration Depository Filing Fees

AGENCY: Securities and Exchange Commission.

ACTION: Order.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is, for nine months, waiving Investment Adviser Registration Depository annual and initial filing fees for all advisers.

EFFECTIVE DATE: The order will become effective on November 1, 2008.

FOR FURTHER INFORMATION CONTACT: Keith Kanyan, IARD System Manager, at 202-551-6737, Daniel S. Kahl, Branch Chief, at 202-551-6730, or Iarules@sec.gov, Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-5041.

DISCUSSON:

Section 204(b) of the Investment Advisers Act of 1940 ("Advisers Act") authorizes the Commission to require investment advisers to file applications and other documents through an entity designated by the Commission, and to pay reasonable costs associated with such filings.[1] In 2000, the Commission designated the Financial Industry Regulatory Authority Regulation ("FINRA") as the operator of the Investment Adviser Registration Depository ("IARD") system. At the same time, the Commission approved,

[1] 15 U.S.C. 80b-4(b).

as reasonable, filing fees.[2] The Commission later required advisers registered or registering with the SEC to file Form ADV through the IARD.[3] Over 11,000 advisers now use the IARD to register with the SEC and make state notice filings electronically through the Internet.

Commission staff, representatives of the North American Securities Administrators Association, Inc. ("NASAA"),[4] and representatives of FINRA periodically hold discussions on IARD system finances. In the early years of operations, SEC-associated IARD revenues exceeded projections while SEC-associated IARD expenses were lower than estimated, resulting in a surplus. In 2005, FINRA wrote a letter to SEC staff recommending a waiver of annual fees for a one year period. The Commission concluded that this was appropriate and waived annual fees.[5] In 2006, FINRA wrote to the staff again, this time recommending a two-year waiver of all fees to continue to reduce the surplus. The Commission agreed and issued another order waiving all IARD fees.[6] As a result of these two waivers, the surplus was reduced from $9 million in 2005 to $5 million.

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2 Designation of NASD Regulation, Inc., to Establish and Maintain the Investment Adviser Registration Depository; Approval of IARD Fees, Investment Advisers Act Release No. 1888 (July 28, 2000) [65 FR 47807 (Aug. 3, 2000)]. FINRA is formerly known as NASD.

3 Electronic Filing by Investment Advisers; Amendments to Form ADV, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)].

4 The IARD system is used by both advisers registering or registered with the SEC and advisers registered or registering with one or more state securities authorities. NASAA represents the state securities administrators in setting IARD filing fees for state-registered advisers.

5 Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2439 (Oct. 7, 2005)

6 Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2564 (Oct. 26, 2006).

FINRA has again written to Commission staff, recommending that the waiver of annual IARD fees and the waiver of initial IARD filing fees for SEC-registered advisers be extended for an additional nine months to July 31, 2009.[7] Based on projections of expected SEC-associated IARD revenues and SEC-associated IARD expenses for the next nine months, the Commission believes that the current SEC-associated surplus exceeds the amount needed for operations and system enhancements during this period, and accordingly believes that an extension of the current waiver of both annual and initial filing fees through July 31, 2009 is appropriate in order to continue reducing the SEC-associated surplus. This action is expected to waive approximately $4 million in IARD system fees that SEC-registered advisers would incur, and should reduce the SEC-associated surplus to approximately $3.7 million. The fee waiver will apply to all annual updating amendments filed by SEC-registered advisers from November 1, 2008 through July 31, 2009 and to all initial applications for registration filed by advisers applying for SEC registration from November 1, 2008 through July 31, 2009.

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[7] The recommendation to waive fees through July 2009 corresponds to the expiration of the SEC's contract with FINRA to operate the IARD.

IT IS THEREFORE ORDERED, pursuant to sections 204(b) and 206(A) of the Investment Advisers Act of 1940, that:

For annual updating amendments to Form ADV filed from November 1, 2008 through July 31, 2009, the fee otherwise due from SEC-registered advisers is waived, and for initial applications to register as an investment adviser with the SEC filed from November 1, 2008 through July 31, 2009, the fee otherwise due from the applicant is waived.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Acting Secretary

Dated: October 30, 2008

Commissioner Aguilar
and Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58884/October 30, 2008

INVESTMENT COMPANY ACT OF 1940
Release No. 28479/October 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13285

In the Matter of

W. DANIEL WILLIAMS,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) and 21C OF THE SECURITIES EXCHANGE ACT OF 1934 and SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO W. DANIEL WILLIAMS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against W. Daniel Williams ("Williams" or "Respondent").

II.

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

Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to W. Daniel Williams ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Respondent

1. **W. Daniel Williams** ("Williams"), age 47, resides in New York, New York and has been a licensed securities professional since 1985. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets LLC as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

Other Relevant Parties

2. **Lazard Capital Markets LLC** ("Lazard Capital Markets") is registered with the Commission as a broker-dealer (File No. 8-2595) pursuant to Section 15(b) of the Exchange Act, with its principal place of business in New York, New York. Lazard Freres & Co. LLC 's capital markets assets were separated from its other businesses and transferred to Lazard Capital Markets in 2005.[2] At all relevant times, Lazard Freres & Co. LLC was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and provided securities brokerage services to institutional customers.

3. **Louis Gregory Rice** ("Rice"), age 42, resides in New York, New York and has been a licensed securities professional since 1987. From 1987 until he resigned in March 2005, Rice held various positions with Lazard Capital Markets. He became a managing director in 1996 and from 1996 to 2005, was the head of Lazard Capital Markets' equity sales and trading department in the United States, supervising, among others, Williams.

4. **FMR Co., Inc.** ("Fidelity") is registered with the Commission as an investment adviser (File No. 801-3447) pursuant to Section 203(c) of the Investment Advisers Act of 1940 ("Advisers Act"), with its principal place of business in Boston, Massachusetts. Fidelity is a wholly owned subsidiary of Fidelity Management & Research Company ("FMR"), which is also an investment adviser registered with the Commission (File No. 801-7884) pursuant to Section 203(c) of the Advisers Act. Fidelity provides portfolio management services as a sub-adviser to certain customers of FMR, including approximately 350 registered investment companies

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

[2] For purposes of this Order, unless otherwise described, the term "Lazard Capital Markets" includes its predecessor entity, Lazard Freres & Co., LLC.

marketed under the "Fidelity Investments" trade name and managed by FMR and its affiliates (the "Fidelity Funds").[3]

5. **Thomas H. Bruderman** ("Bruderman"), age 39, lives in Boston, Massachusetts. He was a domestic equity trader at Fidelity from 1998 until December 2004.[4]

Facts

Summary

6. These proceedings concern Williams' provision of extensive travel and entertainment to Fidelity equity trader Thomas H. Bruderman and certain other members of Fidelity's equity trading desk. The members of Fidelity's equity trading desk who received such travel and entertainment included equity securities traders, whose responsibilities included directing securities transactions for the Fidelity Funds to securities brokerage firms for execution.

7. From 2000 through 2004 (the "Relevant Period"), in an effort to generate brokerage business, Williams, expensed to Lazard Capital Markets over $100,000 in connection with taking Bruderman and certain other Fidelity traders on trips to exotic locations, lodging them at fancy hotels, and providing them with tickets to concerts and, in one instance, an expensive gift.[5] In addition, in connection with Bruderman's bachelor party, Williams provided Bruderman with adult entertainment.

8. Lazard Capital Markets received substantial business from Fidelity traders during the period that Williams and certain other Lazard Capital Markets employees provided travel, entertainment and gifts to Fidelity traders. Throughout the Relevant Period, the brokerage commissions Williams, together with the other Lazard Capital Markets employees, generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. For example, from 2001 to 2003, Fidelity commissions generated by Fidelity traders to whom Williams and certain other Lazard Capital Markets employees provided travel, entertainment and gifts constituted an average of over 16% of Lazard Capital Markets' annual commission revenue

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[3] On March 5, 2008, the Commission instituted a related administrative proceeding against Fidelity. *See In the Matter of Fidelity Management & Research Co. and FMR Co. Inc.*, Advisers Act Release No. 2713, Admin. Proc. File No. 3-19276 (March 5, 2008).

[4] On March 5, 2008, the Commission instituted a related administrative proceeding against Bruderman and nine other employees of Fidelity's equity trading desk. *See In the Matter of Scott DeSano, et al.*, Admin. Proc. File No. 3-12978 (March 5, 2008).

[5] Simultaneously with the commencement of this proceeding, the Commission has issued Orders with respect to Lazard Capital Markets and Messrs. Rice, David L. Tashjian and Robert A. Ward. *See* the following Commission Orders: *In the Matter of Lazard Capital Markets LLC*, Admin. Proc. File No. 3-13281 (October 30, 2008); *In the Matter of Louis Gregory Rice*, Admin. Proc. File No. 3-13282 (October 30, 2008); *In the Matter of David L. Tashjian*, Admin. Proc. File No. 3-13284 (October 30, 2008); and *In the Matter of Robert A. Ward*, Admin. Proc. File No. 3-13283 (October 30, 2008).

during that period. During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

9. Bruderman was the primary recipient of Williams's lavish entertainment of Fidelity traders. During the Relevant Period, Williams expensed over $100,000 in connection with entertaining and providing travel and an expensive gift to Bruderman. During the same period, Bruderman (who also received travel, entertainment and gifts from other Lazard Capital Markets employees) personally directed Fidelity securities orders to Lazard Capital Markets that generated a total of approximately $21.6 million in commissions for Lazard Capital Markets, over ten percent of Lazard Capital Markets' total commission revenue during that five-year period.

10. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. Bruderman and the other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of registered investment companies (the Fidelity Funds), because Fidelity is the adviser to those funds. Bruderman's and the other Fidelity traders' receipt of travel, entertainment and gifts from Williams constituted compensation within the prohibition of Section 17(e)(1) of the Investment Company Act.

11. As a result of his conduct, Williams aided and abetted and caused Bruderman's and certain other Fidelity traders' violations of Section 17(e)(1) of the Investment Company Act.

Background

12. Prior to joining Lazard Capital Markets, while working as a sales trader for a competitor broker-dealer, Williams had developed business relationships with certain Fidelity equity traders. In or about 1998, Rice, the head of Lazard Capital Markets' equity sales and trading department, hired Williams and some of his colleagues in an effort to increase the department's brokerage business. Williams was given access to a travel and entertainment budget, which he was able to access through a Lazard Capital Markets-issued credit card.

13. Lazard Capital Markets' policies prohibited providing gifts in excess of $100. From 2001 through at least mid-2004, Lazard Capital Markets' Compliance Manual stated:

> An employee may not give any gratuity in excess of $100 per person per year to any principal, officer, or employee of another ... *financial institution....* Records shall be retained for at least three years of all such gratuities and compensation for inspection by Exchange examiners. (emphasis added).

Lazard Capital Markets also subjected its managing directors and employees to the prerequisites of relevant law and reasonable conduct and required that:

> Any questions regarding the application or interpretation of behavior or conduct that may be acceptable must be brought to the attention of the General Counsel or his designee *before* any action is taken. (emphasis added).

Williams's Lavish Entertainment of Certain Fidelity Employees

14. During the Relevant Period, Williams expensed to Lazard Capital Markets over $100,000 in connection with entertaining and providing travel and an expensive gift to Bruderman and a few other Fidelity employees. The travel and entertainment consisted of trips, including air travel, luxury accommodations, meals and other entertainment, as well as a $4,565 watch.

15. Examples of the trips that Williams (often along with certain other Lazard Capital Markets employees) provided are as follows:

a. During 2001, Williams, generally together with other Lazard Capital Markets employees, took Bruderman on at least four out-of-town trips, including two trips to California (during which Williams expensed approximately $19,000, and that cost Lazard Capital Markets in total nearly $80,000), an excursion to Florida (during which Williams expensed approximately $20,000, and that cost Lazard Capital Markets in total nearly $60,000), and a trip to Mexico (which cost Lazard Capital Markets over $11,000, all of which Williams expensed).

b. In November 2002, Williams joined Bruderman and certain other Fidelity employees on a week long golf junket to Las Vegas and Cabo San Lucas, Mexico. While another broker organized this annual event, dubbed the "Fall Classic," Williams expensed hotel costs (the Bellagio in Las Vegas and Hotel Esperanza in Cabo San Lucas), several dinners, and golf fees, all of which cost Lazard Capital Markets over $21,000.

c. In or about August 2002 and again in or about August 2003, Williams, together with other Lazard Capital Markets employees, took certain clients, including at least one Fidelity trader, on trips to the Red Tail Golf Club, near Toronto, Canada. The total cost to Lazard Capital Markets for this trip was over $34,000 in 2002 and $43,000 in 2003.

d. In or about March 2003, Williams, together with other Lazard Capital Markets employees, joined with representatives of other brokerage firms to pay for Bruderman's bachelor party in Miami. Williams and the other Lazard Capital Markets employees provided several rooms at the Delano hotel, including a $3,000 per night suite. In addition, Williams provided Bruderman with adult entertainment. Williams expensed over $25,000 on this trip, which cost Lazard Capital Markets in total over $50,000.

Lazard Capital Markets Received Substantial Business from Fidelity During the Period Williams Provided Travel, Entertainment and Gifts to Fidelity Certain Traders

16. During the Relevant Period, Williams used travel, entertainment and gifts in a manner that violated Lazard Capital Markets' policies requiring that entertainment be reasonable, based on the nature, scale and frequency of the entertainment targeted toward Bruderman.

17. Throughout the Relevant Period, the brokerage commissions Lazard Capital Markets generated from Fidelity traders to whom Williams and certain other Lazard Capital Markets employees provided travel, entertainment and gifts were a significant portion of Lazard Capital Markets' overall commission revenue. In addition, the commissions Lazard Capital Markets received from the Fidelity Funds grew after Williams joined Lazard Capital Markets. In 1998, the year Lazard Capital Markets hired Williams and his colleagues, Lazard Capital Markets received $1.4 million in commissions from Fidelity. By contrast, during the 2001 to 2003 period, for example, Williams and certain other Lazard Capital Markets employees were responsible for generating the following commissions from Fidelity, representing the following percentages of Lazard Capital Markets' overall gross commission revenue:

Year	Approximate Gross Commission Revenue Generated From Fidelity	Approximate Percentage of Lazard Capital Markets' Overall Commission Revenue
2001	$7.4 million	16.2%
2002	$7.2 million	16.4%
2003	$6.1 million	16.1%

During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

18. Bruderman, the primary beneficiary of Williams' largesse, alone sent trades generating a total of $21.6 million in brokerage commissions to Lazard Capital Markets during the Relevant Period, as follows:

2000	$3.6 million
2001	$6.4 million
2002	$5.6 million
2003	$3.8 million
2004	$2.2 million

The commissions generated from Bruderman represented over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

19. The travel, entertainment and gifts Williams provided to Bruderman and a few other Fidelity traders constituted prohibited "compensation" within the scope of Section 17(e)(1) of the Investment Company Act.

Violations of the Federal Securities Laws

20. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. A violation of Section 17(e)(1) is complete upon receipt of the compensation. Bruderman and certain other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of investment companies (the Fidelity Funds), because Fidelity advises those funds. Bruderman and certain other Fidelity traders' receipt of travel, entertainment and gifts from Williams constituted compensation in violation of Section 17(e)(1) of the Investment Company Act. As a result of the conduct above, Williams willfully aided and abetted and caused those violations.

Undertakings

21. Respondent Williams shall provide the Commission, within 10 days after the end of the three month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

22. In determining whether to accept the Offer, the Commission considered these undertakings.

IV.

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

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

A. Respondent Williams cease and desist from committing or causing any violations and any future violations of Section 17(e)(1) of the Investment Company Act.

B. Respondent Williams be, and hereby is suspended from association with any broker or dealer, 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 for a period of three months, effective on the second Monday following the entry of this Order.

C. IT IS FURTHER ORDERED that Respondent shall pay a civil money penalty in the amount of $25,000.00 to the United States Treasury within 10 days of entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 W. Daniel Williams 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 David P. Bergers, Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110-1424.

D. Respondent Williams shall comply with the undertakings enumerated in paragraph 21, above.

By the Commission.

Florence E. Harmon
Acting Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Aguilar and Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58881/October 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13282

In the Matter of **LOUIS GREGORY RICE,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AS TO LOUIS GREGORY RICE**

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 Louis Gregory Rice ("Rice" or "Respondent").

II.

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

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Respondent

1. **Louis Gregory Rice** ("Rice"), age 42, resides in New York, New York and has been a licensed securities professional since 1987. From 1987 until he resigned in March 2005, Rice held various positions with Lazard Capital Markets LLC ("Lazard Capital Markets").[2] He became a managing director in 1996 and from 1996 to 2005, was the head of Lazard Capital Markets' equity sales and trading desk in the United States, supervising, among others, Robert A. Ward and W. Daniel Williams.

Other Relevant Parties

2. **Lazard Capital Markets** is registered with the Commission as a broker-dealer (File No. 8-2595) pursuant to Section 15(b) of the Exchange Act, with its principal place of business in New York, New York. Lazard Freres & Co. LLC 's capital markets assets were separated from its other businesses and transferred to Lazard Capital Markets in 2005. At all relevant times, Lazard Freres & Co. LLC was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and provided securities brokerage services to institutional customers.

3. **FMR Co., Inc.** ("Fidelity") is registered with the Commission as an investment adviser (File No. 801-3447) pursuant to Section 203(c) of the Investment Advisers Act of 1940 ("Advisers Act"), with its principal place of business in Boston, Massachusetts. Fidelity is a wholly owned subsidiary of Fidelity Management & Research Company ("FMR"), which is also an investment adviser registered with the Commission (File No. 801-7884) pursuant to Section 203(c) of the Advisers Act. Fidelity provides portfolio management services as a sub-adviser to certain customers of FMR, including approximately 350 registered investment companies marketed under the "Fidelity Investments" trade name and managed by FMR and its affiliates (the "Fidelity Funds").[3]

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

[2] For purposes of this Order, unless otherwise described, the term "Lazard Capital Markets" includes its predecessor entity, Lazard Freres & Co., LLC.

[3] On March 5, 2008, the Commission instituted a related administrative proceeding against Fidelity. *See In the Matter of Fidelity Management & Research Co. and FMR Co. Inc.*, Advisers Act Release No. 2713, Admin. Proc. File No. 3-19276 (March 5, 2008).

4. **Robert A. Ward** ("Ward"), age 47, resides in New York, New York and has been a licensed securities professional since 1983. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

5. **W. Daniel Williams** ("Williams"), age 47, resides in Westport, Connecticut and has been a licensed securities professional since 1985. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

6. **Thomas H. Bruderman** ("Bruderman"), age 39, lives in Boston, Massachusetts. He was a domestic equity trader at Fidelity from 1998 until December 2004.[4]

Facts

Summary

7. These proceedings concern the failure of Rice, the head of Lazard Capital Markets' equity sales and trading desk, to supervise certain Lazard Capital Markets sales traders' provision of extensive travel, entertainment and gifts to certain members of Fidelity's equity trading desk. From 2000 to 2004 (the "Relevant Period"), two Lazard Capital Markets registered representatives under Rice's supervision, Ward and Williams, expensed to Lazard Capital Markets approximately $300,000 in connection with entertaining and providing travel and gifts to Fidelity equity trader Thomas H. Bruderman and certain other members of Fidelity's equity trading desk. Among other things, Ward and Williams took Bruderman on trips to Europe, the Bahamas, Florida, and Napa Valley, California. These trips included airfare or lodging at high-end hotels and, on occasion, adult entertainment. Ward and Williams also provided Bruderman with tickets to concerts, race car driving lessons and expensive wine; and contributed to the expenses associated with Bruderman's elaborate bachelor party. On occasion Ward provided Bruderman and certain other Fidelity traders with drugs, including the drug commonly referred to as "ecstasy."[5]

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[4] On March 5, 2008, the Commission instituted a related administrative proceeding against Bruderman and nine other employees of Fidelity's equity trading desk. *See In the Matter of Scott DeSano, et al.*, Advisers Act Release No. 2715, Admin. Proc. File No. 3-12978 (March 5, 2008).

[5] Simultaneously with the commencement of this proceeding, the Commission has issued Orders with respect to Lazard Capital Markets and Messrs. Ward, Williams and David L. Tashjian. *See* the following Commission Orders: *In the Matter of Lazard Capital Markets LLC*, Admin. Proc. File No. 3-13281 (October 30, 2008); *In the Matter of Robert A. Ward*, Admin. Proc. File No. 3-13283 (October 30, 2008); *In the Matter of W. Daniel Williams*, Admin. Proc. File No. 3-13285 (October 30, 2008); and *In the Matter of David L. Tashjian*, Admin. Proc. File No. 3-13284 (October 30, 2008).

8. Rice viewed the provision of travel and entertainment as a part of a strategy – in competition with other securities brokerage firms – to increase Lazard Capital Markets' brokerage business with the Fidelity Funds. To that end, Rice encouraged Ward and Williams to supply Bruderman and certain other Fidelity traders with travel and entertainment. Throughout the Relevant Period, the brokerage commissions Ward and Williams generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. For example, from 2001 to 2003, Fidelity commissions generated by Fidelity traders to whom Ward and Williams provided travel, entertainment and gifts constituted an average of over 16% of Lazard Capital Markets' annual commission revenue during that period. During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

9. During the Relevant Period, Bruderman personally directed Fidelity securities orders to Ward and Williams that generated approximately $21.6 million in commissions - over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

10. Section 17(e)(1) of the Investment Company Act of 1940 ("Investment Company Act") makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. Bruderman and the other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of registered investment companies (the Fidelity Funds), because Fidelity is the adviser to those funds. Bruderman's and the other Fidelity traders' receipt of travel, entertainment and gifts from Ward and Williams constituted compensation within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

11. Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act, authorizes the Commission to sanction a person associated with, or at the time of the alleged misconduct was associated with, a broker or dealer for failing reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such a violation, if that person is subject to the person's supervision.

12. As the head of Lazard Capital Markets' equity sales and trading desk and a licensed securities professional, Rice was responsible for being familiar with, and ensuring that employees under his supervision fully complied with, Lazard Capital Markets' travel and entertainment policies and applicable securities rules and regulations. Rice was aware of the nature and frequency of most of the travel, entertainment and gifts that Ward and Williams provided to Bruderman and certain Fidelity traders and failed reasonably to respond to red flags that certain of their conduct violated both Lazard Capital Markets' policies and the applicable securities rules and regulations.

13. As a result of the conduct described above, Rice failed reasonably to supervise, within the meaning of Section 15(b)(6) of the Exchange Act, incorporating by reference Section

15(b)(4)(E) of the Exchange Act, Ward and Williams, with a view to preventing their aiding and abetting and causing violations of Section 17(e)(1) of the Investment Company Act.

Background

14. From at least 1996 through 2005, Rice headed Lazard Capital Markets' equity sales and trading desk. In 1998, Rice hired Ward and Williams from another brokerage firm in an effort to increase Lazard Capital Markets' brokerage business. From 1998 until they resigned in 2005, Ward and Williams reported to Rice.

15. Ward and Williams were given access to a travel and entertainment budget, which they were able to access through Lazard Capital Markets-issued credit cards. The equity sales and trading desk had a common office calendar, which Rice could access, on which its employees would list their travel and entertainment events. Equity sales and trading desk employees would prepare vouchers identifying their travel and entertainment expenses, which would be submitted to Lazard Capital Markets for reimbursement.

16. From 2000 through at least January 2003, Rice directly reviewed Ward's and Williams' entertainment expenses. In January 2003, Ward and Williams became managing directors, after which their expenses were directly reviewed by Lazard Capital Markets' chief financial officer. Rice, however, remained Ward's and Williams' supervisor and still had access to the common office calendar in which they continued to document entertainment events.

Lazard Capital Markets' Policies

17. Lazard Capital Markets' policies prohibited providing gifts in excess of $100. From 2001 through at least mid-2004, Lazard Capital Markets' Compliance Manual stated:

> An employee may not give any gratuity in excess of $100 per person per year to any principal, officer, or employee of another ... *financial institution....* Records shall be retained for at least three years of all such gratuities and compensation for inspection by Exchange examiners. (emphasis added).

Lazard Capital Markets also subjected its managing directors and employees to the prerequisites of relevant law and reasonable conduct and required that:

- Any questions regarding the application or interpretation of behavior or conduct that may be acceptable must be brought to the attention of the General Counsel or his designee *before* any action is taken. (emphasis added).

18. Lazard Capital Markets' General Supervision manual made it clear that supervisors were responsible for ensuring employee compliance with its gifts and entertainment policies. Under the heading "Conflicts of Interest," the manual provided that:

> Supervisory Personnel are responsible for being familiar with these [gifts and gratuities] rules, and they must make certain that the employees under their supervision fully comply with them. Any doubts or concerns regarding the propriety of a gift or gratuity should be brought to the attention of the Legal and Compliance Department.

19. Under the heading "Entertainment of Customers," Lazard Capital Markets' General Supervision Manual stated:

> Firm policy provides that a Managing Director must approve all entertainment expenditures and document their approval in writing on the appropriate forms.... If a Supervisor confronts a compliance problem concerning the entertainment of customers, he should immediately contact the Legal and Compliance Department to plan an appropriate response.

Ward and Williams Aided and Abetted and Caused Bruderman's and Certain Other Fidelity Traders' Violations of Section 17(e)(1) of the Investment Company Act

20. During the Relevant Period, with Rice's overt or tacit approval, Ward and Williams expensed to Lazard Capital Markets over $300,000 in connection with providing travel, entertainment and gifts to Bruderman and a few other Fidelity traders. The travel, entertainment and gifts consisted of approximately 15 trips (several of which Rice attended), including air travel, luxury accommodations, meals and/or other entertainment; numerous expensive gifts such as a $1,750 golf instructional video, $1,300 case of wine and $1,329 humidor; and a number of tickets to concerts and the theater.

21. On certain occasions, Ward provided prohibited compensation in the form of drugs, including "ecstasy," to Bruderman and a few other Fidelity traders. Most of the drugs were provided in connection with entertainment events, such as concerts or trips, which were paid for by Lazard Capital Markets. Rice failed reasonably to respond to red flags that indicated that Ward provided drugs to Fidelity employees on some of these occasions.

22. The travel, entertainment and gifts provided to Bruderman and certain other Fidelity traders by Ward and Williams constituted prohibited "compensation" within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

Lazard Capital Markets Received Substantial Business from Fidelity During the Period Ward and Williams Provided Travel, Entertainment and Gifts to Fidelity Certain Traders

23. Rice viewed the provision of travel and entertainment as part of a strategy – in competition with other securities brokerage firms – to increase Lazard Capital Markets' brokerage business with the Fidelity Funds. To that end, Rice encouraged Ward and Williams to supply Bruderman and certain other Fidelity traders with travel and entertainment.

24. Throughout the Relevant Period, the brokerage commissions Ward and Williams generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. In addition, the commissions Lazard Capital Markets received from the Fidelity Funds grew after Ward joined Lazard Capital Markets. In 1998, the year Lazard Capital Markets hired Ward and Williams, Lazard Capital Markets received $1.4 million in commissions from Fidelity. By contrast, during the 2001 to 2003 period, for example, Ward and Williams were responsible for generating the following commissions from Fidelity, representing the following percentages of Lazard Capital Markets' overall gross commission revenue:

Year	**Approximate Gross Commission Revenue Ward and Williams Generated From Fidelity**	**Approximate Percentage of Lazard Capital Markets' Overall Commission Revenue**
2001	$7.4 million	16.2%
2002	$7.2 million	16.4%
2003	$6.1 million	16.1%

During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

25. Bruderman, the primary beneficiary of Ward's and Williams' largesse, alone sent trades generating a total of $21.6 million in brokerage commissions to Lazard Capital Markets during the Relevant Period, as follows:

2000	$3.6 million
2001	$6.4 million
2002	$5.6 million
2003	$3.8 million
2004	$2.2 million

The commissions generated from Bruderman represented over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

Rice Failed to Supervise Ward and Williams

26. Rice supervised Ward and Williams and was responsible for being familiar with, and ensuring that they and other employees under his supervision fully complied with, Lazard Capital Markets' travel and entertainment policies and applicable securities rules and regulations. Rice failed to discharge the duties placed upon him, and permitted Ward and Williams to provide travel, entertainment and gifts to Fidelity employees in violation of applicable rules, regulations and policies. He openly encouraged Ward and Williams to provide travel and entertainment to Bruderman and certain other Fidelity traders, and otherwise ignored obvious indicia of excessive gifts and entertainment, in an effort to generate brokerage business for Lazard Capital Markets.

27. Rice was aware of the nature and extent of much of the travel, entertainment and gifts that Ward and Williams provided to Bruderman and certain Fidelity traders. He joined Ward and Williams on several out-of-town trips, during which Ward and Williams provided airfare, extravagant lodging, and/or other entertainment. Until they were made managing directors in January 2003, Rice reviewed and approved each of Ward's and Williams' travel and entertainment expenses and approved extravagant events, such as assorted trips to resorts in Florida and California. He failed reasonably to respond to numerous red flags that were contrary to Lazard Capital Markets' policies and in violation of Section 17(e)(1) of the Investment Company Act. Had Rice appropriately responded to the concerns raised by this conduct, it is likely he could have prevented and detected Ward's and Williams' securities law violations.

Violations

28. As a result of the conduct described above, Rice failed reasonably to supervise Ward and Williams, with a view to preventing their aiding and abetting and causing of Fidelity's employees' violations of Section 17(e)(1) of the Investment Company Act, within the meaning of Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act.

Undertakings

29. Respondent Rice agrees to provide the Commission, within 10 days after the end of the 6-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

30. In determining whether to accept the Offer, the Commission considered these undertakings.

IV.

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

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

A. Respondent Rice be, and hereby is, suspended from acting in a supervisory capacity for any broker or dealer for a period of six months, effective on the second Monday following the entry of this Order.

B. IT IS FURTHER ORDERED that Respondent Rice shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $60,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 Rice 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 David P. Bergers, Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110-1424.

By the Commission.

Florence E. Harmon
Acting Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Aguilar and Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 58883/October 30, 2008

INVESTMENT COMPANY ACT OF 1940
Release No. 28478/October 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13284

In the Matter of **DAVID L. TASHJIAN,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 and SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO DAVID L. TASHJIAN**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against David L. Tashjian ("Tashjian" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 9(b) and (f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to David L. Tashjian ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Respondent

1. **David L. Tashjian**, age 53, resides in New York, New York and has been a licensed securities professional since 1982. From 1992 until 2006, when he resigned, Tashjian held various senior positions with Lazard Freres & Co. and Lazard Capital Markets LLC, becoming a managing director in 1993 and, for a period of time, serving on the firm's management committee. In 2002, Tashjian became the head of Lazard Capital Markets LLC's U.S. sales and trading department, a position he held until 2005, when he was asked to take over Lazard Capital Markets LLC's equity sales and trading desk.

Other Relevant Parties

2. **Lazard Capital Markets LLC** ("Lazard Capital Markets") is registered with the Commission as a broker-dealer (File No. 8-2595) pursuant to Section 15(b) of the Exchange Act, with its principal place of business in New York, New York. Lazard Freres & Co. LLC 's capital markets assets were separated from its other businesses and transferred to Lazard Capital Markets in 2005.[2] At all relevant times, Lazard Freres & Co. LLC was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and provided securities brokerage services to institutional customers.

3. **FMR Co., Inc.** ("Fidelity") is registered with the Commission as an investment adviser (File No. 801-3447) pursuant to Section 203(c) of the Investment Advisers Act of 1940 ("Advisers Act"), with its principal place of business in Boston, Massachusetts. Fidelity is a wholly owned subsidiary of Fidelity Management & Research Company ("FMR"), which is also an investment adviser registered with the Commission (File No. 801-7884) pursuant to Section 203(c) of the Advisers Act. Fidelity provides portfolio management services as a sub-adviser to certain customers of FMR, including approximately 350 registered investment companies marketed under

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

[2] For purposes of this Order, unless otherwise described, the term "Lazard Capital Markets" includes its predecessor entity, Lazard Freres & Co., LLC.

the "Fidelity Investments" trade name and managed by FMR and its affiliates (the "Fidelity Funds").[3]

4. **Louis Gregory Rice** ("Rice"), age 42, resides in New York, New York and has been a licensed securities professional since 1987. From 1987 until he resigned in March 2005, Rice held various positions with Lazard Capital Markets. He became a managing director in 1996 and from 1996 to 2005, was the head of Lazard Capital Markets' equity sales and trading department in the United States, supervising, among others, Robert A. Ward and W. Daniel Williams and, from 2000 onwards, reporting to Tashjian.

5. **Robert A. Ward** ("Ward"), age 47, resides in New York, New York and has been a licensed securities professional since 1983. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

6. **W. Daniel Williams** ("Williams"), age 47, resides in Westport, Connecticut and has been a licensed securities professional since 1985. From April 1998 until his resignation in March 2005, he was associated with Lazard Capital Markets as a registered account executive in the equity sales and trading department, becoming a managing director in January 2003.

7. **Thomas H. Bruderman** ("Bruderman"), age 39, lives in Boston, Massachusetts. He was a domestic equity trader at Fidelity from 1998 until December 2004.[4]

Facts

Summary

8. These proceedings concern Tashjian's provision of extensive travel, entertainment and gifts to Fidelity equity trader Thomas H. Bruderman, and Tashjian's failure to supervise Ward and Williams, two Lazard Capital Markets registered representatives within his supervisory authority, who provided travel, entertainment and gifts to certain Fidelity traders. The members of Fidelity's equity trading desk who received such travel, entertainment and gifts included equity securities traders, whose responsibilities included directing securities transactions for the Fidelity Funds to securities brokerage firms for execution.[5]

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[3] On March 5, 2008, the Commission instituted a related administrative proceeding against Fidelity. *See In the Matter of Fidelity Management & Research Co. and FMR Co. Inc.*, Advisers Act Release No. 2713, Admin. Proc. File No. 3-19276 (March 5, 2008).

[4] On March 5, 2008, the Commission instituted a related administrative proceeding against Bruderman and nine other employees of Fidelity's equity trading desk. *See In the Matter of Scott DeSano, et al.*, Advisers Act Release No. 2715, Admin. Proc. File No. 3-12978 (March 5, 2008).

[5] Simultaneously with the commencement of this proceeding, the Commission has issued Orders with respect to Lazard Capital Markets and Messrs. Ward, Williams and Louis Gregory Rice. *See* the following Commission Orders: *In the Matter of Lazard Capital Markets LLC*, Admin. Proc. File No. 3-13281 (October 30, 2008); *In the Matter of Robert A. Ward*, Admin. Proc. File No. 3-13283 (October 30, 2008); *In the Matter of W. Daniel Williams*,

9. From 2000 through 2004 (the "Relevant Period"), in an effort to generate brokerage business for Lazard Capital Markets, Tashjian expensed over $350,000 to entertain Bruderman and to provide him with certain gifts. Among other things, Tashjian took Bruderman to the Bahamas, Florida and California, providing him with airfare and lodging at high-end hotels. He also provided Bruderman with expensive wine, and incurred expenses at an adult entertainment establishment for Bruderman's elaborate bachelor party.

10. Tashjian failed reasonably to respond to red flags indicating that two Lazard Capital Markets registered representatives within his supervisory authority, Ward and Williams, also provided extravagant travel and entertainment to Bruderman and certain other Fidelity equity traders. Among other things, he accompanied Ward or Williams on six trips during which they provided Bruderman with lavish lodging, meals and entertainment. Tashjian also failed to respond to red flags indicating that during some of the trips and entertainment events, Ward provided Bruderman and certain other Fidelity traders with drugs, including the drug commonly referred to as "ecstasy."

11. By his behavior, Tashjian set an example for Ward and Williams to provide travel and entertainment to Fidelity employees, in an effort to increase Lazard Capital Markets' business with the Fidelity Funds. Throughout the Relevant Period, the brokerage commissions Lazard Capital Markets generated from Fidelity were a significant portion of Lazard Capital Markets' overall commission revenue. For example, from 2001 through 2003, Fidelity commissions generated by traders to whom Tashjian, Ward and Williams provided travel, entertainment and gifts constituted an average of over 16% of Lazard Capital Markets' annual commission revenue during that period. During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

12. During the Relevant Period, Bruderman personally directed Fidelity securities orders to Lazard Capital Markets – specifically, to Ward and Williams – that generated approximately $21.6 million in commissions - over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

13. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. Bruderman and the other Fidelity traders were affiliated persons of Fidelity, which is an affiliated person of registered investment companies (the Fidelity Funds), because Fidelity is the adviser to those funds. Bruderman's receipt of travel, entertainment and gifts from Tashjian, and Bruderman's and the other Fidelity traders' receipt of travel, entertainment and gifts from Ward and Williams constituted compensation within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

Admin. Proc. File No. 3-13285 (October 30, 2008); and *In the Matter of Louis Gregory Rice*, Admin. Proc. File No. 3-13282 (October 30, 2008).

14. As a result of his conduct, Tashjian aided and abetted and caused Bruderman's violations of Section 17(e)(1) of the Investment Company Act.

15. Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act, authorizes the Commission to sanction a person associated with, or at the time of the alleged misconduct was associated with, a broker or dealer for failing reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such a violation, if that person is subject to the person's supervision.

16. As the head of Lazard Capital Markets' U.S. sales and trading department and a licensed securities professional, Tashjian was responsible for being familiar with, and ensuring that employees for whom he had supervisory responsibility fully complied with, Lazard Capital Markets' travel and entertainment policies and the applicable securities rules and regulations. Tashjian was aware of the nature of the travel and entertainment that Ward and Williams provided to Bruderman and failed reasonably to respond to red flags indicating that their conduct violated both Lazard Capital Markets' policies and the applicable securities rules and regulations.

17. As a result of the conduct described above, Tashjian failed reasonably to supervise, within the meaning of Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act, Ward and Williams, with a view to preventing their aiding and abetting and causing violations of Section 17(e)(1) of the Investment Company Act.

Tashjian Aided and Abetted and Caused Bruderman's Violations of Section 17(e)(1) of the Investment Company Act

18. During the Relevant Period, Tashjian expensed to Lazard Capital Markets over $350,000 in connection with entertaining and providing gifts and travel primarily to Bruderman. The travel, entertainment and gifts consisted primarily of trips including air travel, luxury accommodations, meals and other entertainment as well as certain gifts, such as wine.

19. Examples of the travel, entertainment and gifts that Tashjian provided are as follows:

a. In March 2001, Tashjian, accompanied by Rice, Ward, Williams, took Bruderman on two separate trips to resorts in Florida and California. Tashjian provided for most of the lodging, meals and entertainment, expensing nearly $70,000 (the total cost of the trips was over $100,000).

b. In April and October 2001, Tashjian took Bruderman on two separate trips to resorts in California, providing lodging and entertainment. The total cost to Lazard Capital Markets for these trips was over $40,000, all of which Tashjian expensed.

c. In November 2001, Tashjian took Bruderman and their respective significant others by private plane for a four day trip to the Bahamas. Tashjian provided for the private airfare, meals and lodging. The total cost for Lazard Capital Markets for the trip was over $49,000, nearly all of which Tashjian expensed.

d. In April 2002, Tashjian took Bruderman and their respective significant others for a four day trip to Nassau, Bahamas. Tashjian provided for the party's private jet travel to Nassau, lodging and several meals. The total cost for Lazard Capital Markets for the trip was over $53,000, all of which Tashjian expensed.

e. In September 2002, Tashjian took Bruderman, their respective significant others, and two others clients from firms other than Fidelity and their spouses, to the Bahamas. Tashjian provided for the private airfare, lodging and several meals. The total cost for Lazard Capital Markets for the trip was over $70,000, all of which Tashjian expensed.

f. In March 2003, Tashjian attended a portion of Bruderman's bachelor party in Miami, where he expensed lodging, meals and entertainment that cost Lazard Capital Markets over $4,000. Coupled with the expenses Ward, Williams and Rice incurred for this event, the total cost for Lazard Capital Markets was over $50,000.

20. The travel, entertainment and gifts Tashjian provided to Bruderman constituted prohibited "compensation" within the scope of Section 17(e)(1) of the Investment Company Act.

Ward and Williams Aided and Abetted and Caused Bruderman's and Certain Other <u>Fidelity Traders' Violations of Section 17(e)(1) of the Investment Company Act</u>

21. During the Relevant Period, Tashjian failed reasonably to respond to red flags indicating that Ward and Williams expensed to Lazard Capital Markets over $300,000 in connection with providing travel, entertainment and gifts to Bruderman and a few other Fidelity traders. The travel, entertainment and gifts consisted of approximately 15 trips (at least of six which Tashjian attended), including air travel, luxury accommodations, meals and other entertainment.

22. On certain occasions, Ward provided prohibited compensation in the form of drugs, including "ecstasy," to Bruderman and a few other Fidelity traders. Most of the drugs were provided in connection with entertainment events, such as concerts or trips, which were paid for by Lazard Capital Markets. Tashjian failed reasonably to respond to red flags indicating that Ward provided drugs to Fidelity employees on these occasions.

23. The travel, entertainment and gifts provided to Bruderman and certain other Fidelity traders by Ward and Williams constituted prohibited "compensation" within the scope of the prohibition of Section 17(e)(1) of the Investment Company Act.

Lazard Capital Markets Received Substantial Business from Fidelity During the Period
Tashjian, Ward and Williams Provided Travel, Entertainment and Gifts to Certain Fidelity Traders

24. Tashjian viewed the provision of travel, entertainment and gifts as part of a strategy – in competition with other securities brokerage firms – to increase Lazard Capital Markets' brokerage business with the Fidelity Funds. By his own behavior, Tashjian set an example that encouraged Ward and Williams to supply Bruderman and certain other Fidelity traders with travel and entertainment.

25. Throughout the Relevant Period, the brokerage commissions Lazard Capital Markets generated from Fidelity traders to whom Tashjian, Ward and Williams provided travel, entertainment and gifts were a significant portion of Lazard Capital Markets' overall commission revenue. In addition, the commissions Lazard Capital Markets received from the Fidelity Funds grew after Ward and Williams joined Lazard Capital Markets. In 1998, the year Lazard Capital Markets hired Ward and Williams, Lazard Capital Markets received $1.4 million in commissions from Fidelity. By contrast, during the 2001 to 2003 period, for example, Lazard employees who provided travel, entertainment and gifts to Fidelity traders were responsible for generating the following commissions from Fidelity, representing the following percentages of Lazard Capital Markets' overall gross commission revenue:

Year	**Approximate Gross Commission Revenue Ward and Williams Generated From Fidelity**	**Approximate Percentage of Lazard Capital Markets' Overall Commission Revenue**
2001	$7.4 million	16.2%
2002	$7.2 million	16.4%
2003	$6.1 million	16.1%

During the Relevant Period, commissions from Fidelity far exceeded commissions from any other Lazard Capital Markets customer.

26. Bruderman, the primary beneficiary of Tashjian's, Ward's and Williams' travel, entertainment and gifts, alone sent trades generating a total of $21.6 million in brokerage commissions to Lazard Capital Markets – specifically to Ward and Williams – during the Relevant Period, as follows:

2000	$3.6 million
2001	$6.4 million
2002	$5.6 million
2003	$3.8 million
2004	$2.2 million

The commissions generated from Bruderman represented over ten percent of Lazard Capital Markets' overall commission revenue during that five-year period.

Tashjian Failed to Supervise Ward and Williams

27. Lazard Capital Markets' policies prohibited providing gifts in excess of $100. From 2001 through at least mid-2004, Lazard Capital Markets' Compliance Manual stated:

> An employee may not give any gratuity in excess of $100 per person per year to any principal, officer, or employee of another ... *financial institution*.... Records shall be retained for at least three years of all such gratuities and compensation for inspection by Exchange examiners. (emphasis added).

Lazard Capital Markets also subjected its managing directors and employees to the prerequisites of relevant law and reasonable conduct and required that:

> Any questions regarding the application or interpretation of behavior or conduct that may be acceptable must be brought to the attention of the General Counsel or his designee *before* any action is taken. (emphasis added).

28. Lazard Capital Markets' General Supervision manual made it clear that supervisors were responsible for ensuring employee compliance with its gifts and entertainment policies. Under the heading "Conflicts of Interest," the manual provided that:

> Supervisory Personnel are responsible for being familiar with these [gifts and gratuities] rules, and they must make certain that the employees under their supervision fully comply with them. Any doubts or concerns regarding the propriety of a gift or gratuity should be brought to the attention of the Legal and Compliance Department.

29. Under the heading "Entertainment of Customers," Lazard Capital Markets' General Supervision Manual stated:

> Firm policy provides that a Managing Director must approve all entertainment expenditures and document their approval in writing on the appropriate forms.... If a Supervisor confronts a compliance problem concerning the entertainment of customers, he should immediately contact the Legal and Compliance Department to plan an appropriate response.

30. During the Relevant Period, Tashjian headed Lazard Capital Markets' U.S. capital markets group and, later, Lazard Capital Markets' U.S. sales and trading department. As a supervisor and licensed securities professional, Tashjian was responsible for being familiar with, and ensuring that employees under his supervision, including Ward and Williams, fully complied with Lazard Capital Markets' travel and entertainment policies and the applicable securities rules and regulations. Tashjian failed to discharge the duties placed upon him and permitted Ward and Williams to provide travel and entertainment to Fidelity employees in violation of applicable rules,

regulations and policies. By his behavior, he set an example that encouraged Ward and Williams to provide travel and entertainment to Bruderman and certain other Fidelity traders in an effort to generate brokerage business for Lazard Capital Markets.

31. Tashjian failed reasonably to respond to red flags concerning the nature and extent of the travel and entertainment that Ward and Williams provided to Bruderman and certain Fidelity traders. He joined Ward and Williams on several out-of-town trips, during which he, Ward and Williams provided airfare, extravagant lodging, and other entertainment. Despite red flags, he failed reasonably to monitor whether, when he was not present, Ward and Williams continued to provide extravagant entertainment to Bruderman and certain other Fidelity employees, in violation of Section 17(e)(1) of the Investment Company Act. Had Tashjian appropriately responded to the concerns raised by this conduct, it is likely he could have prevented and detected Ward's and Williams' securities law violations.

Violations

32. Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, or an affiliate of an affiliate, when acting as an agent, to accept compensation from any source (other than a salary or wages from the registered investment company) for the purchase or sale of any property to or for the registered investment company. A violation of Section 17(e)(1) is complete upon receipt of the compensation. Bruderman was an affiliated person of Fidelity, which is an affiliated person of investment companies (the Fidelity Funds), because Fidelity advises those funds. Bruderman's receipt of travel, entertainment and gifts from Tashjian constituted compensation in violation of Section 17(e)(1) of the Investment Company Act. As a result of the conduct above, Tashjian willfully aided and abetted and caused those violations.

33. As a result of the conduct described above, Tashjain failed reasonably to supervise Ward and Williams, with a view to preventing their aiding and abetting and causing of Fidelity's employees' violations of Section 17(e)(1) of the Investment Company Act, within the meaning of Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act.

Undertakings

34. Respondent Tashjian shall provide the Commission, within 10 days after the end of the nine month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

35. In determining whether to accept the Offer, the Commission considered these undertakings.

IV.

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

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

A. Respondent Tashjian cease and desist from committing or causing any violations and any future violations of Section 17(e)(1) of the Investment Company Act.

B. Respondent Tashjian be, and hereby is suspended from association with any broker or dealer, 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 for a period of nine (9) months, effective on the second Monday following the entry of this Order.

C. IT IS FURTHER ORDERED that Respondent Tashjian shall pay a civil money penalty in the amount of $75,000 to the United States Treasury. Payment shall be made in the following installments: (1) $25,000 within 10 days of entry of this Order, (2) $12,500 within 90 days of entry of this Order, (3) $12,500 within 180 days of entry of this Order, (4) $12,500 within 270 days of entry of this Order, and (5) $12,500 within 364 days of entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire balance of the civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. 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 cover letter that identifies Tashjian 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 David P. Bergers, Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110-1424.

D. Respondent Tashjian shall comply with the undertakings enumerated in paragraph 34, above.

By the Commission.

Florence E. Harmon
Acting Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary