SECURITIES AND EXCHANGE COMMISSION

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Christopher Cox served as the SEC Chairman from August 5, 2005 to January 20, 2009.

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

36 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59195 / January 5, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13323

In the Matter of Robert L. Flickinger II, Respondent.	CORRECTED ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 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. Flickinger, 39, is a resident of Pompano Beach, Florida and was owner, president, and principal of Mercer Capital Securities, LLC ("Mercer Capital Securities"), a broker-dealer registered with the Commission from April 2004 until October 2004.

2. Flickinger also was the president and majority shareholder of Mercer Capital, Inc. ("Mercer Capital"), a Delaware company and former commodities broker-dealer based in Boca Raton, Florida and Portland, Oregon, which, with Flickinger, offered and sold its own securities from September 2004 until November 2006. Flickinger additionally was a director of Mercer Capital Management, a Florida corporation and unregistered securities broker-dealer that under Flickinger's direction offered and sold the securities of two Wyoming limited partnerships, Tri-State I and Tri-State II, from December 2005 until November 2006.

3. On December 3, 2008, the United States District Court for the Southern District of Florida entered a final judgment by consent against Flickinger in the civil action entitled Securities and Exchange Commission v. Mercer Capital, Inc., et al., Case No. 06-81080-CIV-JOHNSON, permanently enjoining him from violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) and Rule 10b-5 of the Exchange Act, ordering him to pay disgorgement and a civil penalty pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act, and barring him from participating in an offering of penny stock as defined by Exchange Act Rule 3a51-1 or serving as an officer or director of a public company.

4. The Commission's complaint alleged that in connection with the unregistered offer and sale of the securities of the Tri-State entities and Mercer Capital Flickinger made material misrepresentations and omissions in statements to investors concerning, among other things, the business relationships and prior investment performance of the Tri-State entities and the source of purported returns paid to investors. During Flickinger's conduct alleged in the Commission's complaint, from at least September 2004 through October 2004, Flickinger was associated with Mercer Capital 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 Flickinger's Offer.

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

UNITED STATES OF AMERICA
BEFORE the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59205 / January 6, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2915 / January 6, 2009

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13326

In the Matter of **PAVLOS MELETIOU, CERTIFIED ACCOUNTANT** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(3)[1] of the Commission's Rules of Practice against Pavlos Meletiou ("Respondent" or "Meletiou").

II.

The Commission finds that:

A. RESPONDENT

1. Meletiou was a partner of the accounting firm PKF Cyprus while AremisSoft Corporation ("AremisSoft") was a public company. He was responsible for the

[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 the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

audits and reviews of AremisSoft subsidiaries that PKF Cyprus conducted. He was a certified accountant in Cyprus. He is a citizen of Cyprus, where he currently resides.

B. CIVIL INJUNCTION

2. On September 23, 2008, the U.S. District Court for the Southern District of New York entered a final default judgment against Meletiou, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5 and from aiding and abetting future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Exchange Act Rules 12b-20, 13a-1 and 13b2-1. *Securities and Exchange Commission v. Savvides & Partners/PKF Cyprus, Pavlos Meletiou, et. al.*, 06 CV 2223 (CSH) (S.D.N.Y.)

3. The Commission's complaint, filed March 21, 2006, alleged, among other things, that Meletiou signed unqualified audit reports on behalf of PKF Cyprus, a Cyprus-based accounting firm, for AremisSoft subsidiaries in 1999 and 2000 that falsely stated that the audits were conducted in accordance with U.S. Generally Accepted Auditing Standards ("GAAS") and that the AremisSoft subsidiaries' financial statements were fairly presented in conformity with U.S. Generally Accepted Accounting Principles ("GAAP"). The complaint further alleged that Meletiou was responsible for the audits and reviews of the AremisSoft subsidiaries and that he attended meetings with senior AremisSoft executives in which the AremisSoft financial fraud was openly discussed.

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Meletiou from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of these findings, the Commission deems it appropriate and in the public interest that Meletiou be temporarily suspended from appearing or practicing before the Commission as an accountant.

IT IS HEREBY ORDERED that Meletiou be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an accountant. This Order shall be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Meletiou may within thirty days after service of this Order file a petition with the Commission to lift the temporary suspension. If the Commission within thirty days after service of the Order receives no petition, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission shall, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Meletiou by registered mail at his last known address.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59204 / January 6, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2914 / January 6, 2009

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13325

In the Matter of **R.K. DHAWAN, CHARTERED ACCOUNTANT** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(3)[1] of the Commission's Rules of Practice against R.K. Dhawan ("Respondent" or "Dhawan").

II.

The Commission finds that:

A. RESPONDENT

1. Dhawan, a chartered accountant in India, is the founding partner of R.K. Dhawan & Co. ("Dhawan & Co."). He was responsible for the reviews and audits of AremisSoft

[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 the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Corporation ("AremisSoft") subsidiaries conducted by Dhawan & Co. He is a citizen of India, where he currently resides.

B. CIVIL INJUNCTION

2. On September 23, 2008, the U.S. District Court for the Southern District of New York entered a final default judgment against Dhawan, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5 and from aiding and abetting future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Exchange Act Rules 12b-20, 13a-1 and 13b2-1. *Securities and Exchange Commission v. Savvides & Partners/PKF Cyprus, Pavlos Meletiou, et. al.*, 06 CV 2223 (CSH) (S.D.N.Y.).

3. The Commission's complaint alleged, among other things, that Dhawan and Co. issued audit reports on nine AremisSoft subsidiaries in 2000 signed by its partner Dhawan that falsely stated that the audits were conducted in accordance with U.S. Generally Accepted Auditing Standards ("GAAS") and that the AremisSoft subsidiaries' financial statements were presented in conformity with U.S. Generally Accepted Accounting Principles ("GAAP"). The complaint further alleged that the companies' false financial statements were included as part of AremisSoft's consolidated financial statements filed with AremisSoft's year 2000 Form 10-K. The complaint alleged that five of the nine companies were never in fact acquired by AremisSoft and four were shells with insignificant assets, revenues, and income. The complaint also alleged that Dhawan had no training or experience in U.S. GAAS or U.S. GAAP.

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Dhawan from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of these findings, the Commission deems it appropriate and in the public interest that Dhawan be temporarily suspended from appearing or practicing before the Commission as an accountant.

IT IS HEREBY ORDERED that Dhawan be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an accountant. This Order shall be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Dhawan may within thirty days after service of this Order file a petition with the Commission to lift the temporary suspension. If the Commission within thirty days after service of the Order receives no petition, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission shall, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Dhawan by registered mail at his last known address.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59206 / January 6, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2916 / January 6, 2009

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13327

In the Matter of R.K. DHAWAN & CO. Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3) OF THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(3)[1] of the Commission's Rules of Practice against R.K. Dhawan & Co. ("Respondent" or "Dhawan & Co.").

II.

The Commission finds that:

A. RESPONDENT

1. Dhawan & Co. is an accounting firm with offices in New Delhi, India and Bangalore, India. R.K. Dhawan, a chartered accountant in India, is the founding partner of

[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 the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

4 of 36

Dhawan & Co. He was responsible for the reviews and audits of AremisSoft Corporation subsidiaries conducted by Dhawan & Co.

III.

B. CIVIL INJUNCTION

1. On September 23, 2008, the U.S. District Court for the Southern District of New York entered a final default judgment against Dhawan & Co., permanently enjoining it from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5 and from aiding and abetting future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Exchange Act Rules 12b-20, 13a-1 and 13b2-1. *Securities and Exchange Commission v. Savvides & Partners/PKF Cyprus, Pavlos Meletiou, et. al.*, 06 CV 2223 (CSH) (S.D.N.Y.).

2. The Commission's complaint alleged, among other things, that Dhawan and Co. issued audit reports on nine AremisSoft subsidiaries in 2000 signed by its partner Dhawan that falsely stated that the audits were conducted in accordance with U.S. Generally Accepted Auditing Standards ("GAAS") and that the AremisSoft subsidiaries' financial statements were presented in conformity with U.S. Generally Accepted Accounting Principles ("GAAP"). The complaint further alleged that the companies' false financial statements were included as part of AremisSoft's consolidated financial statements filed with AremisSoft's year 2000 Form 10-K. The complaint alleged that five of the nine companies were never in fact acquired by AremisSoft and four were shells with insignificant assets, revenues, and income. The complaint also alleged that Dhawan had no training or experience in U.S. GAAS or U.S. GAAP.

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Dhawan & Co. from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of these findings, the Commission deems it appropriate and in the public interest that Dhawan & Co. be temporarily suspended from appearing or practicing before the Commission as an accountant.

IT IS HEREBY ORDERED that Dhawan & Co. be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an accountant. This Order shall be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Dhawan & Co. may within thirty days after service of this Order file a petition with the Commission to lift the temporary suspension. If the Commission within thirty days after service of the Order receives no petition, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission shall, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Dhawan & Co. by registered mail at its last known address.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59220 / January 8, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13328

In the Matter of **JASON A. KOLAKOWSKI,** **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 Jason A. Kolakowski ("Kolakowski" or "Respondent").

II.

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

III.

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

1. Respondent Jason A. Kolakowski, 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 December 19, 2008, a final judgment was entered by consent against Kolakowski, permanently enjoining him 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 Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Jarrod McMillin, et al., Civil Action Number 07-cv-2636-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, Kolakowski 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 Kolakowski 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 Kolakowski's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Kolakowski be, and hereby is barred from association with any broker or dealer, with the right to reapply for association after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59224 / January 9, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2918 / January 9, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-11887

In the Matter of Debra McClister, CPA	: ORDER GRANTING APPLICATION FOR : REINSTATEMENT TO APPEAR AND PRACTICE : BEFORE THE COMMISSION AS AN ACCOUNTANT : RESPONSIBLE FOR THE PREPARATION OR : REVIEW OF FINANCIAL STATEMENTS REQUIRED : TO BE FILED WITH THE COMMISSION

On April 7, 2005, Debra McClister, CPA ("McClister") was denied the privilege of appearing or practicing as an accountant before the Commission as a result of settled public administrative proceedings instituted by the Commission against McClister pursuant to Rule 102(e) of the Commission's Rules of Practice.[1] McClister consented to the entry of the order without admitting or denying the findings therein. This order is issued in response to McClister's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

In 2000, Mail.com, Inc. ("EasyLink")[2] improperly recognized and reported advertising revenue from barter transactions because it failed to comply with Generally Accepted Accounting Principles, as set forth in Emerging Issues Task Force Issue No. 99-17, "Accounting for Advertising Barter Transactions" ("EITF 99-17"), which became effective on January 20, 2000. EITF 99-17 generally permits recognition of revenue and expense from barter transactions only if the fair value of advertising surrendered in a barter transaction can be determined based on a company's comparable cash transactions in the prior six months. In 2000, McClister, who served as EasyLink's Executive Vice President and Chief Financial Officer, was unaware of EITF 99-17, and thus failed to apply it to the company's barter transactions. By failing to

[1] *See* Accounting and Auditing Enforcement Release No. 2227 dated April 7, 2005. McClister was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.
[2] In April 2001, Mail.com, Inc. changed its name to EasyLink Services Corporation. In order to maintain consistency with the April 7, 2005 order, the company is referred to as EasyLink herein.

comply with EITF 99-17, EasyLink overstated its revenue for fiscal 2000 by $4.85 million, or 8.6% of total revenue. EasyLink also overstated its revenue for the third quarter of 2000 by 16.1%. EasyLink reported its overstated revenue figures in its 2000 Form 10-K and its Form 10-Q for the third quarter of 2000. McClister participated in the payment arrangements for some of the barter transactions, and failed to account for the barter deals properly. She prepared and/or signed EasyLink's Form 10-K and Form 10-Q that included the overstated barter revenue.

In her capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, McClister attests that she will undertake to have her work reviewed by the independent audit committee of any company for which she works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. McClister is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If she should wish to resume appearing and practicing before the Commission as an independent accountant, she will be required to submit an application to the Commission showing that she has complied and will comply with the terms of the original order, which denied her privilege of appearing and practicing before the Commission as an accountant, in this regard. Therefore, the denial of McClister's privilege of appearing or practicing before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."[3] This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by McClister, it appears that she has complied with the terms of the April 7, 2005 order denying her the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to her character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against her pursuant to Rule 102(e) of the Commission's Rules of Practice, and that McClister, by undertaking to have her work reviewed by the independent audit committee of any company for which she works, or in some other manner acceptable to the Commission, in her practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

[3] Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Debra McClister, CPA is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59223 / January 9, 2009

Admin. Proc. File No. 3-12890

In the Matter of the Application of

THOMAS W. HEATH, III
c/o Gary P. Naftalis
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036

For Review of Disciplinary Action Taken by

NYSE REGULATION, INC.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE -- REVIEW OF DISCIPLINARY PROCEEDING

Conduct Inconsistent with Just and Equitable Principles of Trade

Former registered representative of member firm of national securities exchange alleged to have engaged in conduct inconsistent with just and equitable principles of trade by disclosing material non-public information. Held, exchange's findings of violation and imposition of sanctions are sustained.

APPEARANCES:

Gary P. Naftalis, Alan R. Friedman, Michael S. Oberman, and Joel M. Taylor, of Kramer Levin Naftalis & Frankel LLP, for Thomas W. Heath, III.

Linda Riefberg, Martin Mazur, Allen Boyer, Kathleen Lynch, and David Camuzo, for Financial Industry Regulatory Authority, Inc., Department of Enforcement, on behalf of NYSE Regulation, Inc.

Appeal filed: November 15, 2007
Last brief received: February 22, 2008

I.

Thomas W. Heath, III, a former registered representative of New York Stock Exchange, LLC ("NYSE" or the "Exchange") member firm J.P. Morgan Securities Inc. ("JPMorgan"), appeals from NYSE disciplinary action. 1/ The Exchange found that Heath disclosed material non-public information regarding the pending acquisition of a JPMorgan client, and that such disclosure constituted "conduct . . . inconsistent with just and equitable principles of trade" in violation of NYSE Rule 476(a)(6). The NYSE censured Heath and imposed a $100,000 fine. This appeal followed. We base our findings on an independent review of the record.

II.

At the time of the disclosure, Heath was an investment banker and managing director at JPMorgan, but was planning his imminent departure from JPMorgan to begin a new position as a managing director and group head at Banc of America Securities LLC ("BofA"). In early 2005, Tony Ursano, Jr., Global Head of BofA's Financial Institutions Group, began recruiting Heath to head BofA's bank group. After interviews with several senior BofA executive officers, in mid-February Heath was offered and orally accepted a position as BofA's "Head of Banks." In accepting the BofA offer, Heath informed Ursano that he was committed to completing a transaction at JPMorgan before starting the new position at BofA.

While Heath was having these discussions with BofA, JPMorgan had been advising Hibernia Bank ("Hibernia") in connection with its proposed acquisition by Capital One Corp. ("Capital One"). Heath was JPMorgan's "client executive" in charge of the Hibernia account, with primary responsibility for securing and managing JPMorgan's role as Hibernia's lead advisor and primary investment banking representative in connection with the transaction.

After accepting the BofA offer, Heath informed his JPMorgan supervisor of his impending move, but stated his intention to "get [JPMorgan] engaged on Hibernia and get the

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1/ On July 26, 2007, the Commission approved proposed rule changes in connection with the consolidation of the member firm regulatory functions of the National Association of Securities Dealers ("NASD") and NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Pursuant to this consolidation, the member firm regulatory and enforcement functions and employees of NYSE Regulation, Inc. were transferred to NASD, and the expanded NASD changed its name to Financial Industry Regulatory Authority, Inc. See Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Because the disciplinary action here was taken before the NYSE-NASD consolidation of regulatory operations, we continue to use the designation "NYSE" in this opinion.

deal across the finish line" before resigning. 2/ Heath completed his pre-hire paperwork for BofA on February 16, 2005, and received a draft of an offer letter from BofA on February 25, 2005. During this period, Heath continued to work at JPMorgan on the Hibernia acquisition.

Prior to Heath's start at BofA and five days before the public announcement of the Hibernia deal, Ursano asked Heath to call Eric Corrigan, the then-head of BofA's depository institutions group. Heath and Corrigan's conversation was potentially sensitive because Corrigan had recently been "very disappointed" and "upset" to learn that Heath would be heading the bank group, when Corrigan may have previously thought that they would be co-heads of the bank group. Ursano urged Heath to "let [Corrigan] know you're fair . . . you're going to be a good partner with him . . . you're not going to stomp all over him . . . [and] talk about the business plan going forward."

When Heath and Corrigan spoke the next day, the two discussed overlapping client accounts and changes in the banking landscape. Near the end of the conversation, Corrigan inquired about Heath's then-current project, stating: "there are a lot of rumors out in the marketplace. And [we] . . . know you have a bank deal somewhere down in the south." Heath testified that he initially demurred, but when Corrigan persisted, he eventually responded: "if you really want to know, I will tell you exactly what it is, but you have to understand, you know, I've got a week to go. This is obviously confidential information. The deal is done, bankers have been hired, nothing is going to change. And you just have to understand and respect that," and stipulated that Corrigan could not "act on this in any way."

After Corrigan agreed to keep the information confidential, Heath described the Hibernia acquisition in detail, describing the parties, JPMorgan's role, the percentage of cash consideration, and the rationale for the stock consideration. Heath testified that he was trying to make it clear that the terms and advisors had already been finalized, and thereby protect his client by preempting any efforts by BofA to solicit business in the transaction. By eliciting Corrigan's promise of confidentiality, Heath testified that he believed that he had "put a firewall around the problem." He also testified that he felt that he was "dealing with someone who's going to be a colleague" and "the whole purpose of this [conversation] is to build trust and -- and build a collegiality with."

Despite his agreement to keep the information confidential, that same day Corrigan discussed the acquisition with Tom Chen, the head of BofA's diversified financial services group. Corrigan and Chen discussed contacting Capital One in an attempt to participate in the transaction -- the result that Heath states that he was trying to preempt. Chen left a voicemail message with Capital One that evening indicating his awareness of a "bank deal" and asking to

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2/ Heath points out that he had no monetary stake in completing the acquisition at JPMorgan because he would forfeit any deal-based bonus by resigning prior to fiscal year end. He testified that he was trying to do "the right thing" by delaying his move rather than disrupting the deal.

get involved. Chen's message was not returned. On March 3, while Heath was hosting meetings at his future BofA office and before the acquisition was announced, Corrigan approached him to ask if "there [was] room for other advisors" on the transaction. Heath responded "don't even go there . . . I can't believe you're even saying that."

The Hibernia acquisition was publicly announced on March 6, 2005. That same day the Chairman of JPMorgan's North American Mergers and Acquisitions group called Heath and told him that BofA had called Capital One attempting to get hired with the "name, price, structure, timing" of the transaction. Heath was told that he had been identified as the source of the leak, and that JPMorgan was placing him on leave.

On March 8, Heath briefed Ursano on his disclosure to Corrigan and his understanding of the subsequent course of events. Heath testified that he requested that Ursano "elevate [the issue] internally to the top of the house immediately." The next day, BofA began an investigation. On March 15, 2005, after interviewing Heath, Chen, Corrigan, and Ursano as part of its internal investigation, BofA revoked Heath's employment offer, and terminated Chen and Corrigan. JPMorgan had previously terminated Heath's employment on March 14, 2005.

III.

On January 25, 2006, the NYSE Division of Enforcement (the "Division") charged that Heath's disclosure violated NYSE Rule 476(a)(6) prohibiting conduct inconsistent with just and equitable principles of trade (the "J&E Rule"). On November 24, 2006, the Chief Hearing Officer of the NYSE Hearing Panel issued an order (the "Summary Judgment Order") granting summary judgment to the Division on the issue of liability, concluding that Heath had violated the J&E Rule. 3/ The Summary Judgment Order held that a "violation of the just and equitable principles of trade codified by NYSE Rule 476(a)(6) may occur either through bad faith <u>or</u> unethical conduct." (emphasis in original)

The Summary Judgment Order held that Heath's disclosure was unethical, finding that Heath violated his duty to maintain the confidentiality of material nonpublic information. The order traced the duty of confidentiality to prohibitions on the disclosure of confidential client information in the JPMorgan Code of Conduct (the "Code of Conduct") and to agency law principles, citing "the ethical obligation to which every financial advisor becomes subject upon learning of sensitive, nonpublic information about a client." The order found that Heath's "reasons for making the disclosures -- while certainly lacking any malevolent or deceitful quality -- were, in the final analysis, self-serving in that they were intended to gain the trust of, and thereby smooth things over with, a soon-to-be colleague."

3/ The hearing officer granted summary judgment under NYSE Rule 476(c), which authorizes the hearing officer to "resolve any and all procedural and evidentiary matters and substantive legal motions."

The NYSE Hearing Panel then held a hearing to determine sanctions, taking testimony from Heath and from the JPMorgan executive that had suspended Heath. 4/ On March 15, 2007, the panel imposed a censure and $100,000 fine. On October 17, 2007, the NYSE Board of Directors affirmed the Summary Judgment Order and the Hearing Panel decision, stating that a J&E Rule violation "may be established by a finding of either bad faith or unethical conduct." This appeal followed.

IV.

We agree with the Exchange's finding that Heath's disclosure constituted unethical conduct in violation of the J&E Rule. In disclosing confidential client information, Heath violated one of the most fundamental ethical standards in the securities industry. The duty to maintain the confidentiality of client information is grounded in fundamental fiduciary principles, 5/ and is further codified in the Code of Conduct. The Code of Conduct expressly prohibits the disclosure of confidential information "to anyone outside the firm unless . . . authorized to do so," and instructs that, even when disclosure is permitted, employees should "use [their] judgment to limit the amount of information shared and disclose it only on a need-to-know basis." 6/ The Code of Conduct also states that this obligation to maintain client confidentiality continues after the termination of employment with the firm. 7/

We find that Heath's disclosure was ultimately self-interested and for his, not his principal's, purposes. As Heath testified, "the whole purpose" of his conversation with Corrigan was "to build trust and -- and build . . . collegiality." We concur with the NYSE Hearing Panel's finding that Heath's disclosure "was motivated by a desire to gain the trust of a future colleague."

Heath does not deny that he disclosed material non-public information regarding the Hibernia acquisition. Instead, he contends that his disclosure did not violate the J&E Rule because he was not found to have acted in bad faith. Heath argues that a violation of the J&E Rule must be based on either a finding of bad faith or the violation of another rule or

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4/ The panel also heard testimony in Heath's defense from the former general counsel at JPMorgan, and from a former officer and member of the Hibernia board of directors that had approved the acquisition.

5/ See Restatement (Third) of Agency §8.05 (setting forth an agent's duty "not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party"); see also Jonathan Feins, 54 S.E.C. 366, 372 (1999) (holding that "[a]s agent, [applicant] was obligated to act solely for his customer's benefit, and in his customer's best interests, in completing the transaction").

6/ JPMORGANCHASE CODE OF CONDUCT § 3.1 (November 2004).

7/ Id. at § 5.11.

regulation. 8/ In the alternative, he argues that he had not received "fair notice" that bad faith is not the standard for J&E Rule liability, and that he had not received notice of the specific state of mind finding required to sustain disciplinary action under the rule. Heath further asserts that "[e]ven if the Commission were to accept the [Exchange's] formulation of 'unethical conduct as something broader than bad faith,'" Heath's actions, when considered in light of all of the surrounding circumstances, do not satisfy that standard. Finally, Heath contends that the Exchange's liability finding should be reversed because the issue was improperly decided by an individual hearing officer acting on a motion for summary judgment. We reject these contentions for the reasons outlined below.

A. Standard for J&E Rule Violation

Heath argues that liability under the J&E Rule must be premised on a bad faith finding. As the Exchange points out, however, we have long applied a disjunctive "bad faith or unethical conduct" standard to disciplinary action under the J&E Rule. 9/ This rule incorporates "broad ethical principles," 10/ and focuses on the "ethical implications of the [a]pplicant's conduct." 11/ The rule serves as an industry backstop for the representation "inherent in the relationship,"

8/ It is well-established that a violation of another self-regulatory organization ("SRO") or Commission rule or regulation will also automatically constitute a violation of the J&E Rule. See, e.g., Stephen G. Gluckman, 54 S.E.C. 175, 185 (1999) (noting the Commission's "long-standing and judicially-recognized policy that a violation of another Commission or NASD rule or regulation . . . constitutes a violation of" the NASD rule regarding just and equitable principles of trade).

9/ See, e.g., Robert E. Kauffman, 51 S.E.C. 838, 839 n.5 (1993) ("The most that is required [for a finding of liability under the J&E Rule] is a finding of bad faith or unethical conduct."), aff'd, 40 F.3d 1240 (3d Cir. 1994) (Table); Chris Dinh Hartley, 57 S.E.C. 767, 773 n.13 (2004) ("If no other rule has been violated, a violation of [the J&E Rule] requires evidence that the respondent acted in bad faith or unethically.").

10/ Peter Martin Toczek, 51 S.E.C. 781, 788 n.14 (1993); Kauffman, 51 S.E.C. at 839 n.5; William F. Rembert, 51 S.E.C. 825, 826 n.3 (1993); Jay Frederick Keeton, 50 S.E.C. 1128, 1134 (1992); see also Larry Ira Klein, 52 S.E.C. 1030, 1031-32 (1996) (stating that the J&E Rule "sets out in broad terms the ethical standard against which the conduct of securities professionals is measured").

11/ Timothy L. Burkes, 51 S.E.C. 356, 360 (1993), aff'd, 29 F.3d 630 (9th Cir. 1994) (Table); Ben B. Reuben, 46 S.E.C. 719, 722 n.7 (1976).

between a securities professional and a customer, "that the customer will be dealt with fairly, and in accordance with the standards of the profession." 12/

Promulgated to discipline "a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace," 13/ the J&E Rule focuses on the securities professional's conduct rather than on a subjective inquiry into the professional's intent or state of mind. 14/ Accordingly, a violation of the rule need not be premised on a motive or scienter finding. 15/ For instance, when most recently confronted with another applicant that, like Heath,

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12/ Atlanta-One, Inc., 52 S.E.C. 161, 163-64 (1995) (citing Duker & Duker, 6 S.E.C. 386, 388-89 (1939)), aff'd, 100 F.3d 105 (9th Cir. 1996); see also C. Brock Lippitt & Thomas M. Svalberg, 48 S.E.C. 524, 526 (1986) (sustaining a violation of the rule when "applicants frustrated the legitimate expectations of investors"), aff'd, 876 F.2d 181 (D.C. Cir. 1989); Leonard H. Zigman, 40 S.E.C. 954, 956 (1962) (finding applicant's actions exhibited "an attitude not consistent with the pervasive duty of fair dealing imposed upon those in the securities business").

13/ Daniel Joseph Alderman, 52 S.E.C. 366, 369 (1995) (holding that the deliberate withholding of payments due to clients for over two months violated the J&E Rule), aff'd, 104 F.3d 285 (9th Cir. 1997).

14/ Leonard John Ialeggio, 52 S.E.C. 1085, 1089 (1996) ("By [his] conduct, Ialeggio acted at least unethically, and thus violated" the J&E Rule), aff'd, 185 F.3d 867 (9th Cir. 1999)(Table); see also Svalberg v. SEC, 876 F.2d 181, 184 (D.C. Cir. 1989) (per curiam) (stating that "knowledge of what one is doing and the consequences of those actions suffices" to sustain a violation of the J&E Rule, and that the disciplinary action did not need to be based on a finding "that the subject believed his action to be illegal" (internal citation omitted)).

15/ See Shultz v. SEC, 614 F.2d 561, 570 n.20 (7th Cir. 1980) (declining to reach motive of market maker who violated the J&E Rule when he engaged in transactions "without legitimate economic purpose"); Keith Springer, 55 S.E.C. 632, 646 (2002) ("We need not ascertain Springer's motive in order to find that he committed the violations charged."); Ernest A. Cipriani, Jr., 51 S.E.C. 1004, 1006 n.8 (1994) ("[T]he NASD is not required to demonstrate motive to prove a violation of [the J&E Rule]."); Kenneth Sonken, 48 S.E.C. 832, 836 (1987) (stating that "it is unnecessary to determine the motivation for Sonken's action in order to conclude that tampering with the price of an option series violates just and equitable principles of trade"); Eliezer Gurfel, 54 S.E.C. 56, 63 (1999) ("Proof of scienter is not required to establish a violation of NASD [J&E Rule]."), petition denied, 205 F.3d 400 (D.C. Cir. 2000); Louis Feldman, 52 S.E.C. 19, 21 (1994) ("Scienter is not an element of the [J&E Rule] violation here."). Although Heath suggests that the J&R Rule holdings in these cases were contingent on the violations of other rules and

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appealed an SRO disciplinary decision under the J&E Rule based on a state of mind defense, we explicitly reaffirmed our long-standing view that the rule applies to either conduct committed in bad faith or conduct violating ethical standards. 16/

As noted, Heath's breach of confidentiality violated one of the most basic duties of a securities professional, a duty that is grounded in fiduciary principles and reflected in the Code of Conduct. This conduct was properly subject to discipline under the J&E Rule. We have repeatedly held that the breach of a security professional's duty to a client is sufficient to sustain a J&E Rule violation. For example, in E.F. Hutton & Company Inc., 17/ and Bateman Eichler, Hill Richards, Inc., 18/ we found that applicants violated the rule based on findings that they violated fiduciary duties by engaging in transactions that created conflicts of interest with their customers' trading. These decisions were grounded in fiduciary principles requiring industry professionals to prioritize the interests of clients above their own interests, not in subjective state of mind findings. 19/ Fiduciary principles have consistently driven the analysis in other cases finding unethical conduct under the rule. 20/ Moreover, we have looked to internal firm

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15/ (...continued)
regulations, the J&E Rule was the only rule found to have been violated in Gurfel and Feldman, and the J&E Rule violation in Springer was determined independent of any other rule violation.

16/ Calvin David Fox, 56 S.E.C. 1371, 1377 (2003) (remanding to the Exchange to "expressly consider whether Fox acted in bad faith or unethically").

17/ 49 S.E.C. 829, 833 (1988) (finding that a firm violated the rule in failing to execute a customer's limit order while simultaneously selling shares of the same security for its own account at a price higher than the customer's limit price).

18/ 47 S.E.C. 1025, 1026, 1028 n.7 (1984) (finding that a firm violated the rule in failing to execute customer market orders "fully and promptly, to the greatest extent possible," and allocating shares to its own short position before customer orders), aff'd, 757 F.2d 1066 (9th Cir. 1985).

19/ See Hutton, 49 S.E.C. at 832 ("Our aim is to give effect to the reasonable expectations of the parties to the relationship. Where there is no explicit agreement to the contrary and the relationship is a fiduciary one, the law governing fiduciary duties provides presumptive definition for such expectations.").

20/ Feldman, 52 S.E.C. at 22 (finding the rule was violated even when there was "no specific NASD rule addressing" the applicant's transfer of customer accounts to a new firm without prior consent because "under fundamental principles of agency law such prior consent is required"); see also Ialeggio, 52 S.E.C. at 1089 (submission of improper
(continued...)

compliance policies to inform our determination of whether applicants' conduct, like Heath's, violated the professional standards of ethics covered by the J&E Rule. 21/

Heath relies on Buchman v. SEC, 22/ for the proposition that bad faith is a required element of any violation of the J&E Rule, but Buchman is distinguishable. The Buchman court stated that "a breach of contract between [SRO] members is of no concern to the [SRO] or to the Commission if such breach does not contravene the ethical standards embodied in" the J&E Rule, 23/ and cited the "well-settled" proposition that a "breach of contract is unethical conduct in violation of NASD Rules, only if it is in bad faith, just as conduct violates rule 10b-5 only if there is scienter . . . ." 24/ It concluded that the failure to deliver stock under a stock sale contract did not violate the J&E Rule when the breach was "colorably justified by the confusion as to the true state of the market and as to the applicable law." 25/ The Buchman court cited good faith as the "touchstone" and "measure of culpability," for determining whether a breach of contract was justified or whether the breach constituted unethical conduct under the J&E Rule. 26/ Although the court focused on bad faith as a prerequisite to liability, the court's analysis was grounded in the contractual context of that case. The decision was consistent with long-standing Commission precedent holding that a breach of contract alone is not automatically unethical conduct in violation of the rule, but that such breach may constitute a violation if it was "unethical or

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20/ (...continued)
expense reimbursement request "cast doubt on [applicant's] commitment to the fiduciary standards demanded of registered persons in the securities industry and thus properly are the subject of NASD disciplinary action"); Joseph H. O'Brien, II, 51 S.E.C. 1112, 1115 (1994) ("It is well established that a securities firm has a fiduciary obligation to its customers and to the assets the customers entrust to that firm."); Daniel D. Manoff, 55 S.E.C. 1155, 1163 (2002) (finding that the unauthorized use of a customer's credit card violated the J&E Rule based on a finding that respondent breached his fiduciary duties).

21/ Dan Adlai Druz, 52 S.E.C. 416, 425 (1995) (finding that the respondent violated the J&E Rule by settling customer complaints without notifying the legal department when such action violated firm policy), aff'd, 103 F.3d 112 (D.C. Cir. 1996) (Table); Thomas P. Garrity, 48 S.E.C. 880, 884 (1987) (finding that failure to adhere to limits on trading of options under the firm's compliance policy violated the J&E Rule).

22/ 553 F.2d 816 (2d Cir. 1977).

23/ Id. at 820.

24/ Buchman, 553 F.2d at 821.

25/ Id. at 820.

26/ Id. at 821.

dishonorable" or "without equitable excuse or justification." 27/ Following the Buchman decision, we have continued to focus on bad faith to determine whether a breach of contract, in and of itself, constitutes a violation of the J&E Rule. 28/ As noted above, however, bad faith is not the sole standard, and state of mind findings have not been required, for finding liability under the rule in cases not premised on a breach of contract.

Heath argues that we adopted a general bad faith standard for J&E Rule liability in Nicholas T. Avello, 29/ and in the Commission order in Calvin David Fox. 30/ However, the language Heath cites in both instances was dicta and did not reflect a rejection or modification of established J&E Rule precedent. In Avello, we rejected the applicant's good faith defense because the J&E Rule violation in that case was based on recordkeeping and reporting rule violations. 31/ Although the opinion states in dicta that "we have required a showing that the respondent has acted in bad faith before liability can be found" in the absence of another rule violation, 32/ the J&E Rule violation in Avello was in fact based on underlying rule violations.

27/ See, e.g., Samuel B. Franklin & Co., 38 S.E.C. 113, 116 (1957) ("But not every failure to perform a contract violates the NASD rule; it must also appear that such failure was unethical or dishonorable."); Southern Brokerage Co., 42 S.E.C. 449, 453 (1964) ("[I]t is not our function nor that of the NASD under this rule to adjudicate private contract disputes . . . . 'not every failure to perform a contract violates the NASD rule; it must also appear that such failure was unethical or dishonorable' or that the breach was committed 'without equitable excuse or justification.'" (citations omitted)).

28/ See William D. George, 47 S.E.C. 368, 369-70 (1980) (stating that failure to comply with the terms of an indemnification contract did "not constitute a breach of the NASD's ethical standards unless it appears that [applicant] acted in bad faith"); Robert J. Jautz, 48 S.E.C. 702, 704 (1987) ("[I]t is well established that a breach of contract violates NASD standards only if it is committed in bad faith or is accompanied by unethical conduct.").

29/ Exchange Act Rel. No. 51633 (Apr. 29, 2005), 85 SEC Docket 1299, petition dismissed, 454 F.3d 619 (7th Cir. 2006).

30/ Exchange Act Rel. No. 54840 (Nov. 30, 2006), 89 SEC Docket 1282, aff'd, 2008 U.S. App. LEXIS 6647 (D.C. Cir. 2008) (per curiam).

31/ See supra note 8.

32/ In response to Avello's argument that he could not be found liable because he did not act in bad faith, the opinion stated "[w]hen a violation of [the J&E Rule] is not based on the violation of some other rule, we have required a showing that the respondent has acted in bad faith before liability can be found. There is no bad faith requirement, however, when,

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Heath similarly relies on a footnoted parenthetical in the Fox order that alludes to a bad faith measure of liability under the rule. 33/ Our decision in that case, however, dismissed the appeal of a NYSE decision based on his late filing of the appeal before the NYSE Board of Directors -- not based on the standard for determining a violation of the rule. We noted that the underlying NYSE hearing panel decision had found that "Fox's alleged conduct was in bad faith and unethical," 34/ although our decision did not address those findings. Given the applicant's late filing, our order did not address the merits of the hearing panel's findings or analysis under the rule. 35/

Thus, neither the Avello decision nor the Fox order was based on the standard to be applied to J&E Rule violations in the absence of another rule violation. In Avello, the applicant had violated another rule, and in Fox, we dismissed the appeal without reaching the merits. Accordingly, dicta in these decisions may not reasonably be read as signaling a rejection of the Commission's longstanding liability standard under the J&E Rule.

Heath also cites various cases in which we credited equitable excuses to reverse SRO findings of violations of the J&E Rule. These cases are also distinguishable from the direct breach of a duty to a client presented here. 36/ None of these opinions held that good faith is a

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32/ (...continued)
as here, a violation of [the J&E Rule] is based upon the violation of a Commission rule." 85 SEC Docket at 1302-03.

33/ The order included a footnote describing Jautz as "(holding that if only violation alleged by NASD is failure to observe just and equitable principles of trade, there must be a finding of bad faith)." 89 SEC Docket at 1282 n.3. As previously noted, the Jautz decision itself was based on the contractual context of that case. See supra note 28.

34/ Fox, 89 SEC Docket at 1282.

35/ The Fox order also notes that in our earlier order remanding the proceeding, "we asked the NYSE to address whether Fox's alleged conduct was in bad faith or unethical." 89 SEC Docket at 1282 (emphasis added).

36/ See George R. Beall, 50 S.E.C. 230, 231 (1990) (failure to repay debt to prior employer when the debt had been forgiven decided as breach of contract); George, 47 S.E.C. at 369-70 (failure to reimburse customer under indemnity agreement in the absence of bad faith decided as breach of contract); Kirk A. Knapp, 51 S.E.C. 115, 120 n.20 (1992) (inaccurate NASDAQ filing for which respondent was not responsible); Charles Zandford, 50 S.E.C. 782, 783-84 (1991) (deposit of personal funds to cover a margin call based on the advice of officials responsible for margin compliance); James Anthony Morrill, 51 S.E.C. 1162, 1165 (1994) (failure to pay an arbitration award when
(continued...)

per se defense to a violation of the J&E Rule, and the analysis in these cases often emphasized the unusual circumstances at issue. 37/ Moreover, none of these cases credited a good faith defense for an applicant that, like Heath, violated a non-contractual fiduciary duty owed directly to a client or customer.

B. Fair Notice Challenge to J&E Rule

Heath also contends that he lacked notice that the NYSE could discipline under the J&E Rule for unethical conduct that was not motivated by bad faith. The Supreme Court has stated that notice arguments "may be overcome in any specific case where reasonable persons would know that their conduct is at risk." 38/ Notice requirements should not be "mechanically applied" but rather are to be evaluated based on the context of the regulation at issue. 39/ Accordingly, Heath's notice claim should be evaluated with respect to his "actual conduct" and not "hypothetical situations at the periphery of the [rule's] scope or . . . the conduct of other parties who might not be forewarned by. . . broad language" in the rule. 40/

The Commission and the federal courts have consistently sustained SRO disciplinary decisions based on a finding of unethical conduct under the J&E Rule, deeming the rule fairly

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36/ (...continued)
respondent did not receive notice of the award hearing and relied on advice of SRO official).

37/ See Morrill, 51 S.E.C. at 1164-65 (noting the "unusual situation" in which respondent was pro se and "evidently in good faith, repeatedly brought to the NASD's attention the NASD's apparent failure to give him notice of the rescheduled arbitration hearing"); Zandford, 50 S.E.C. at 783 (noting "the exceptional circumstances of this case -- particularly Zandford's good faith reliance on the advice and counsel of . . . management, including the official in charge of margin requirements").

38/ Maynard v. Cartwright, 486 U.S. 356, 361 (1988).

39/ Village of Hoffman Estates v. Flipside, 455 U.S. 489, 498 (1982) ("The degree of vagueness that the Constitution tolerates -- as well as the relative importance of fair notice and fair enforcement -- depends in part on the nature of the enactment."). Although the Court noted that "a scienter requirement may mitigate a law's vagueness, especially with respect to the adequacy of notice," the Court did not hold that scienter is always required to withstand vagueness review. Id. at 499.

40/ diLeo v. Greenfield, 541 F.2d 949, 953 (2d Cir. 1976).

applied to conduct that "is not ethical and accepted conduct in the securities industry." 41/ In reviewing notice challenges to the J&E Rule, courts have expressly recognized that "an experienced registered representative . . . may be fairly charged with knowledge of the ethical standards of his profession." 42/ Courts have consistently found that the rule "is sufficiently specific and provides an adequate standard of compliance," 43/ even as applied to conduct that does not involve securities or employment-related activities. 44/

As an experienced investment banker, Heath can be fairly charged with notice that his breach of his duty to maintain the confidentiality of his client's information violated the just and equitable principles of trade. Any reasonably prudent securities professional would recognize that the disclosure of confidential client information violates the ethical norms of the industry. Moreover, Heath had actual notice of his duty to maintain the confidentiality of his client's information, further undermining his notice challenge. Heath acknowledged that he had read the JPMorgan Code of Conduct, which explicitly codified his obligation to maintain the strict confidentiality of client information. Heath also testified as to his knowledge of the importance of maintaining client confidentiality, stating that "one of the factors that creates a successful M&A banker is . . . having the judgment of how to use [confidential information] and how to use it in a trustworthy and honest way."

Heath nonetheless argues that he did not have notice that the terms "unethical" and "bad faith," as those terms are used in applying the rule, are meant to have separate meanings. We find this argument unpersuasive. Heath's interpretation deprives the disjunctive language in the standard of any meaning and is contrary to well-established Commission precedent explicitly finding J&E Rule liability without a finding of bad faith. As previously discussed, Heath does identify certain instances of dicta suggesting a bad faith standard for J&E Rule violations.

41/ Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006); see also Alderman v. SEC, 104 F.3d 285, 288-89 (9th Cir. 1997) (finding, when respondent violated duty to act in accordance with "NASD ethical standards," the application of the J&E Rule based on the violation of such duties "cannot have come as a surprise"); Sorrell v. SEC, 679 F.2d 1323, 1326 (9th Cir. 1982) (rejecting due process challenge to J&E Rule). Accord Shultz, 614 F.2d at 571 (holding that a disciplinary rule requiring that market makers "contribute to the maintenance of a fair and orderly market" is "appropriately specific to withstand constitutional scrutiny").

42/ Crimmins v. Am. Stock Exch., 368 F. Supp. 270, 277 (S.D.N.Y. 1973), aff'd 503 F.2d 560 (2d Cir. 1974).

43/ Werner v. SEC, 44 S.E.C. 622, 625 & n.11, aff'd without opinion (D.C. Cir. 1972); see also Rooms, 444 F.3d at 1214; Alderman 104 F.3d at 288.

44/ Vail v. SEC, 101 F.3d 37, 39 (5th Cir. 1996) (per curiam) ("Vail had fair notice" that his non-work conduct "would subject him to sanctions by the NASD.").

However, given our longstanding interpretation of the rule as covering bad faith or unethical conduct, those isolated instances of dicta could not reasonably be interpreted as signaling a reversal of existing precedent directly addressing the standard for liability under the J&E Rule. 45/

Heath cites a series of cases involving disciplinary proceedings against accountants under our former Rule of Practice 2(e). 46/ These cases held that disciplinary action under former Rule 2(e) must be premised on notice of the standard governing the rule, including a specific mental state standard. 47/ Heath cites Checkosky v. SEC, 48/ which held that liability under Rule 2(e) must be based on notice of the mental state "necessary and sufficient" to violate the rule. However, the court's analysis in Checkosky was grounded in our implementation of Rule 2(e) under our "general rulemaking authority" 49/ without a specific statutory mandate. 50/ Under these circumstances, the court cautioned that a broad interpretation of the rule could be deemed "a de facto substantive regulation of the profession" and would "raise questions as to the legitimacy of the rule." 51/

Unlike former Rule 2(e), the Exchange's authority to impose "substantive regulations" on the conduct of securities professionals is grounded in an explicit and longstanding statutory mandate. The Securities Exchange Act of 1934 expressly grants SROs the "statutory responsibility to prevent unethical practices among its membership." 52/ Section 6(b)(5) of the Exchange Act directs national securities exchanges to promulgate and enforce disciplinary rules, among other things, "to promote just and equitable principles of trade . . . and, in general, to

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45/ See supra nn. 29-37 and accompanying text.

46/ 17 C.F.R. § 201.2(e)(1) (1993) (amended and recodified as 17 C.F.R. § 201.102(e)).

47/ See Checkosky v. SEC ("Checkosky I"), 23 F.3d 452 (D.C. Cir. 1994); Checkosky v. SEC ("Checkoksy II"), 139 F.3d 221 (D.C. Cir. 1998); Marrie v. SEC, 374 F.3d 1196 (D.C. Cir. 2004).

48/ Checkosky I, 23 F.3d at 458.

49/ Id. at 456.

50/ The Commission's authority under Rule 102(e) was subsequently codified in the Sarbanes-Oxley Act of 2002, 15 U.S.C. §78d-3. See Marrie, 374 F.3d at 1203.

51/ Checkosky I, 23 F.3d at 459; see also Marrie, 374 F.3d at 1205 ("The Commission's authority to discipline professionals has long been distinguished from the execution of its substantive enforcement functions.").

52/ Valley Forge Sec. Co., 41 S.E.C. 486, 490 (1963).

protect investors and the public interest." 53/ In associating with the Exchange, securities professionals "voluntarily subject [themselves] to the NYSE rules," 54/ and recognize the Exchange's authority "to discipline their members for unethical behavior as well as violations of law." 55/ In contrast to the former distinction between our "authority to discipline professionals" under Rule 2(e) and "the execution of [our] substantive enforcement functions," 56/ the J&E Rule reflects an integral part of the Exchange's express regulatory mandate under the Exchange Act.

Moreover, the court recognized in Marrie that "professional disciplinary rules have withstood vagueness challenges," 57/ and the Rule 2(e) cases cited by Heath do not suggest that the state of mind requirements were meant to be broadly applied to all such disciplinary rules. 58/ We note that courts have rejected notice challenges to disciplinary rules as applied to a wide range of professions without imposing state of mind requirements. 59/ Such challenges have

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53/ 15 U.S.C. § 78f(b); cf. 15 U.S.C. § 78*o*-3(b)(6) (comparable provision for national securities associations).

54/ Gold v. SEC, 48 F.3d 987, 993 (7th Cir. 1995); see also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis, 903 F.2d 109, 113 (2d Cir. 1990) (indicating that the obligations of securities professionals under the disciplinary rules are "contractual in nature").

55/ Paul K. Grassi, Jr., Exchange Act. Rel. No. 52858 (Nov. 30, 2005), 86 SEC Docket 2494, 2497.

56/ Marrie, 374 F.3d at 1205.

57/ See id. (observing that "the Commission could reasonably conclude that any licensed accountant is on notice of professional standards generally . . . . For this reason, professional disciplinary [r]ules have withstood vagueness challenges.").

58/ Although Heath cites a case addressing requisite state of mind findings in disciplinary action taken by the Patent and Trademark Office ("PTO"), the court's analysis in that case focused on whether the PTO's complaint sufficiently charged a violation of the relevant disciplinary rule. Halvonik v. Dudas, 398 F. Supp. 2d 115, 125 (D.D.C. 2005), aff'd, 192 Fed. Appx. 964 (D.C. Cir. 2006) (mem. per curiam).

59/ See, e.g., Arnett v. Kennedy, 416 U.S. 134, 164 (1973) (regulation authorizing discipline of civil servant "for such cause as will promote the efficiency of the service"); Perez v. Hoblock, 368 F.3d 166, 169 (2d Cir. 2004) (racing community rule prohibiting "any action detrimental to the best interests of racing"); LeRoy v. Illinois Racing Board, 39 F.3d 711, 715 (7th Cir. 1994) (racing community rule forbidding "'improper language' or 'improper conduct' by licensees toward regulators"); U.S. v. Hearst, 638 F.2d 1190, 1197 (continued...)

failed even when the regulation "is admittedly flexible, and officials implementing [the] standard will undoubtedly exercise some discretion in interpreting and applying the regulation." 60/ In assessing such notice claims, courts have evaluated the conduct at issue against the professional "norms" of the vocation or profession "as embodied in codes of professional conduct," 61/ but do not require specific state of mind findings. 62/ As discussed above, Heath's disclosure of his client's confidential information violated such norms.

We conclude that Heath failed to demonstrate that he lacked notice that his conduct violated the just and equitable principles of trade covered under the J&E Rule. Heath's disclosure of confidential client information clearly violated the ethical norms of securities professionals protected under the rule. Heath's position is further undercut by the express restrictions on the use of client information in the Code of Conduct.

C. Circumstances Surrounding Heath's Disclosure

Heath points to circumstances which, he claims, excuse his actions based on the context of his disclosure. He asserts that, "[v]iewed objectively, what Mr. Heath did and the reasons for his conduct do not support any finding of wrongdoing approaching bad faith." Among other things, Heath notes that his disclosure was not premeditated, resulted in no personal enrichment and had no effect on the deal or the markets. We are not persuaded, however, that any of the circumstances cited by Heath absolve his conduct; although, as discussed below, they were considered by the Exchange in determining sanctions and by us in assessing those sanctions.

Heath further claims in particular that he was "authorized -- or, at least, was actively attempting -- to protect Hibernia's interest by making the disclosure to freeze out Mr. Corrigan." However, Heath's decision to divulge unquestionably confidential information was not justified on this basis. The record does not indicate that Heath could have reasonably believed that Corrigan was in a position to threaten the transaction, or that detailed disclosure was otherwise necessary to protect Hibernia's interests. The transaction had not been publicly announced and

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59/ (...continued)
(9th Cir. 1980) (disciplinary rule prohibiting "conduct unbecoming a member of the bar"); diLeo, 541 F.2d at 953 (teacher disciplinary rule authorizing disciplinary action for "other due and sufficient cause . . ."); Allen v. City of Greensboro, 452 F.2d 489, 491 (4th Cir. 1971) (disciplinary regulation for police officers prohibiting conduct "unbecoming an officer and a gentleman").

60/ Perez, 368 F.3d at 175.

61/ In re Snyder, 472 U.S. 634, 645 (1985) (interpreting attorney disciplinary rule prohibiting "conduct unbecoming a member of the bar").

62/ Perez, 368 F.3d at 175-76.

Corrigan had not indicated that he had access to any information sufficient to jeopardize the acquisition. When Corrigan referenced "rumors in the marketplace" about "a bank deal somewhere in the south," the reasonable course of action for protecting Hibernia's interest was to decline to discuss the transaction. Instead, Heath chose to divulge highly sensitive information about the critical terms of the transaction.

In addition, Heath cites the testimony and support of a former officer and director of Hibernia who stated that he did not consider Heath's disclosure to be a breach of Hibernia's confidence under the circumstances. However, this former officer testified in his individual capacity, and the record suggests that he was not aware of the disclosure until after it had been made. Heath's duty of confidentiality was owed to Hibernia as his investment banking client -- not to any individual Hibernia officer or director. At the time of Heath's conversation with Corrigan, Heath did not have general authorization to disclose information about the merger except on a need-to-know basis. In the absence of express prior authorization from his client and in accordance with the Code of Conduct, Heath remained bound by his obligation to safeguard information about the acquisition solely for Hibernia's interest.

Heath further argues that he viewed Corrigan as a future colleague and believed that Corrigan had an independent duty to keep the information confidential. In this regard, he cites Corrigan's express assurance of confidentiality and also argues that Corrigan had a separate duty to keep the information confidential because BofA had represented Capital One in other transactions. However, even if Heath did not believe that Corrigan was permitted to act on the information, that belief did not absolve Heath's own disclosure. Heath owed a duty of confidentiality directly to Hibernia, and Corrigan had no legitimate interest in information about the acquisition before the public announcement of the deal. In choosing to disclose the information, Heath favored his interest in establishing a collegial relationship with Corrigan over his client's interest in the confidentiality of highly sensitive and material pricing information. Nor are we persuaded that the lack of demonstrable client harm in this instance excused his disclosure. The ethical prohibition on the disclosure of confidential client information is not contingent upon future harm. 63/

63/ See Reuben, 46 S.E.C. at 722 n.7 ("The absence of actual harm is of little, if any, mitigative moment. This is not a civil action to collect money damages. It is an ethical proceeding. Hence our concern is with the ethical implications of the applicant's conduct. Those implications can be serious even where, as here, no legally cognizable wrong was inflicted.").

V.

Heath also asserts that the hearing officer erred in granting the Division's motion for summary judgment. 64/ Heath argues that the hearing officer did not resolve questions of fact and draw all reasonable inferences in his favor as required by the first prong of the summary judgment standard. Among other things, Heath argues that the hearing officer did not appropriately consider: Corrigan's responsibility to keep the information confidential; Heath's desire to prevent Corrigan from soliciting business in the transaction; testimony from the former Hibernia executive indicating that he did not consider the disclosure to be a breach of confidentiality; and a purported lower risk of harm to the client from the disclosure "given the advanced stage of the" deal. Heath also contends that the second prong of the summary judgment standard was not satisfied, arguing that the J&E Rule requires a "fact sensitive . . . nuanced determination rarely susceptible to a ruling as a matter of law."

In evaluating Heath's arguments on appeal, we have conducted a de novo review of the record. The record includes Heath's on-the-record testimony taken by the Division during its investigation, and Heath's testimony before the NYSE Hearing Panel during the penalty phase of the NYSE hearing. While Heath has disputed whether his disclosure breached his duty to Hibernia, he does not contest the material facts underlying the NYSE's finding of a violation of the rule, i.e., his disclosure of material non-public information regarding the pending merger of his client and the circumstances surrounding his conversation with Corrigan. As noted above, the Exchange's liability finding was based on Heath's violation of established standards of conduct in the industry. Based on our de novo review, we find that the justifications advanced by Heath do not ultimately excuse his breach of one of the most critical responsibilities of a financial advisor. Under the circumstances, we find no prejudice to Heath resulting from the hearing officer's ruling. 65/

64/ In the absence of a legal standard governing summary judgment in the NYSE rules, the hearing officer looked to the Federal Rules of Civil Procedure two prong test for summary judgment when "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c).

65/ See McCarthy v. SEC, 406 F.3d 179, 187 (2d Cir. 2005) (finding that the "due process afforded [the applicant] before the Commission cured any alleged defect" in the proceedings before the NYSE); see also Sorrell v. SEC, 679 F.2d 1323, 1326 (9th Cir. 1982).

The disposition of this case was simplified by the clear breach of confidentiality, and the undisputed facts underlying the violation. The unique factual circumstances of this case notwithstanding, we note that the hearing record for SRO disciplinary action is often best-served by restraint in the granting of summary judgment on the issue of liability. See Frank P. Quattrone, Exchange Act Rel. No. 53547 (Mar. 24, 2006), 87 SEC Docket 2155,

(continued...)

VI.

Section 19(e)(2) of the Exchange Act directs us to sustain the NYSE's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 66/ Heath does not claim, and the record does not show, that the NYSE's action was excessive or oppressive or imposed an undue burden on competition.

The violation here is "neither technical nor esoteric." 67/ Heath disclosed information he knew to be "obviously confidential" regarding the parties, structure and pricing of a pending merger, even if Heath did not perceive his disclosure as violating his duty of confidentiality. The ability to credibly assure a client that such information will be used solely to advance the client's own interests is central to any securities professional's ability to provide informed advice to clients. Disclosure of such information jeopardizes the foundation of trust and confidence crucial to any professional advising relationship. Whether or not the disclosure ultimately harmed his client, it violated the ethical standards to which all members of the industry must adhere and which the Exchange is charged with protecting.

In determining the sanctions, the Exchange considered the mitigating circumstances in this case, including among other things: the lack of premeditation, bad faith, direct client harm or personal enrichment, Heath's elevation of the issue at BofA and cooperation with the Exchange's investigation, and the promise of confidentiality he received from a future colleague. The Exchange also credited Heath's reputation for integrity and trustworthiness, sincere remorse, and the unlikelihood of repetition of the violative conduct. The Exchange ultimately declined to impose an industry bar but felt that a substantial fine was warranted by the serious nature of

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65/ (...continued)
2166 (setting aside NASD action when "NASD improperly granted summary disposition on" the issue of liability). Such restraint is particularly appropriate when the central issue is whether the respondent's conduct violated industry norms.

66/ 15 U.S.C. § 78s(e)(2).

67/ Protective Group Sec. Corp., 51 S.E.C. 1233, 1242 (1994).

Heath's conduct. Under all the circumstances, we agree. We also find that the sanctions imposed by the Exchange were consistent with the public interest. Accordingly, we sustain the NYSE action.

An appropriate order will issue. 68/

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

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

68/ 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. 59223 / January 9, 2009

Admin. Proc. File No. 3-12890

In the Matter of the Application of THOMAS W. HEATH, III c/o Gary P. Naftalis Kramer Levin Naftalis & Frankel LLP 1177 Avenue of the Americas New York, New York 10036 For Review of Disciplinary Action Taken by NYSE REGULATION, INC.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY NATIONAL SECURITIES EXCHANGE

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

ORDERED that the disciplinary action taken by NYSE Regulation, Inc. against Thomas W. Heath, III, be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59226 / January 12, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13329

In the Matter of

Howard Graham,

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 Howard Graham ("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. At all relevant times, Graham was a sales agent of a Massachusetts-based corporation, Braintree Energy, Inc. ("Braintree"), which issued securities in the form of investment contracts and/or fractional interests in oil and gas leases. Graham, 48 years old, is a resident of Ontario, Canada.

2. On December 23, 2008, a final judgment was entered by consent against Graham permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Braintree Energy, Inc. *et al.*, Civil Action Number 3:07-CV-10307, in the United States District Court for the District of Massachusetts.

3. The Commission's complaint, filed on February 20, 2007, alleged that Graham, a Canadian citizen, used Braintree to orchestrate an offering and sale of unregistered securities in the form of investment contracts and/or fractional interests in oil and gas leases. Graham made numerous oral and written misrepresentations between at least 2000 through 2006 to more than 200 investors nationwide and in foreign countries regarding the investors' expected rate of return and their associated investment risks. Graham failed to disclose many material facts to the investors, including that Graham received up to 30% of investor funds. As a result of the scheme, Graham obtained at least $9 million in investor funds and Graham and/or entities controlled by him received approximately $3 million.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Walter
not participating

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2827 / January 12, 2009

INVESTMENT COMPANY ACT OF 1940
Release No. 28580 / January 12, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13332

In the Matter of

GABELLI FUNDS, LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940 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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Gabelli Funds, LLC ("Respondent" or "Gabelli").

II.

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

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

This matter concerns violations of Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1 by two closed-end funds, The Gabelli Convertible and Income Securities Fund Inc. and The Gabelli Utility Trust (collectively, the "Funds"). Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1 require funds to provide shareholders with contemporaneous written statements identifying the source of distributions to shareholders if any portion of the distributions is from a source other than the fund's net income.[2] The purpose of Section 19(a) and Rule 19a-1 is to provide shareholders adequate disclosure of the sources from which distributions are made.

During the period from January 1, 2002 through December 31, 2003 (the "relevant period"), significant portions of all but one of the Funds' shareholder distributions were from shareholder capital and capital gains. None of the distributions was accompanied by a notice that contained the information required by Rule 19a-1. The Funds therefore violated Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1. Pursuant to agreements with the Funds, Gabelli was responsible for the Funds' administrative operations, which included providing Section 19(a) notices to shareholders of the Funds. Gabelli also represented in a 2001 exemptive application to the Commission that notices that comply with Rule 19a-1 would be sent to the Funds' shareholders. Although Gabelli regularly tracked the Funds' performance and knew or was reckless in not knowing that the Funds regularly paid distributions from sources other than net income, it failed to provide contemporaneous notices containing the information required by Rule 19a-1 to the Funds' shareholders. Gabelli thus caused and willfully[3] aided and abetted the Funds' violations of Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1.

Respondent

1. **Gabelli,** an investment adviser registered with the Commission under Section 203(c) of the Advisers Act, provides investment management and administrative services to nine publicly-traded, closed-end investment companies registered under the Investment Company Act, including The Gabelli Convertible and Income Securities Fund Inc. and The Gabelli Utility Trust.

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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] According to Section 19(a)(1) of the Investment Company Act, a fund's "net income" is "accumulated undistributed net income . . . not including profits and losses realized upon the sale of securities or other properties."

[3] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Gabelli's principal place of business is Rye, New York. Gabelli is a subsidiary of GAMCO Investors, Inc. (NYSE: GBL).

Other Relevant Entities

2. **The Gabelli Convertible and Income Securities Fund Inc.**, a closed-end diversified management investment company registered under the Investment Company Act, was incorporated under the laws of Maryland on December 19, 1988. Its shares trade on the New York Stock Exchange under the symbol GCV. The Gabelli Convertible and Income Securities Fund Inc., which seeks a high level of total return through a combination of current income and capital appreciation, pays distributions quarterly. Its fiscal year ends on December 31.

3. **The Gabelli Utility Trust**, a closed-end, non-diversified management investment company registered under the Investment Company Act, was incorporated under the laws of Delaware on February 25, 1999. Its shares trade on the New York Stock Exchange under the symbol GUT. The Gabelli Utility Trust, which seeks long-term capital appreciation, pays distributions monthly. Its fiscal year ends on December 31.

Section 19(a) Violations

4. Section 19(a) of the Investment Company Act prohibits investment companies such as closed-end funds from paying distributions from any source other than net income unless the payments are accompanied by contemporaneous written statements to shareholders disclosing the sources of the distributions. Rule 19a-1 specifies that the written statement must be on a separate paper and clearly indicate what portion of the payment is from: 1) net income (not including capital gains); 2) capital gains; and 3) paid-in surplus or other capital source. The purpose of Section 19(a) and Rule 19a-1 is to afford shareholders adequate disclosure of the sources from which the payments are made so shareholders will not believe that a fund portfolio is generating investment income when, in fact, distributions are paid from other sources, such as shareholder capital or capital gains.[4]

5. During the relevant period, The Gabelli Convertible and Income Securities Fund Inc. and The Gabelli Utility Trust had managed distribution policies (disclosed to shareholders in the Funds' respective prospectuses and annual reports) that require fixed payments to shareholders on a regular basis, regardless of investment performance. Pursuant to these policies, the Gabelli Convertible and Income Securities Fund Inc. paid an annual distribution of 8% of its average NAV to shareholders and The Gabelli Utility Trust paid $.06 per share to shareholders each month. The distribution policies for the Funds provide that to the extent the target distribution payment for any period exceeds net investment income and short-term capital gains, the shortfall is funded with shareholder capital or long-term capital gains.

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[4] Rule 19a-1(g) states: "[t]he purpose of this section, in the light of which it shall be construed, is to afford security holders adequate disclosure of the sources from which dividend payments are made." See SEC Release No. 71, 1941 WL 37715 (Feb. 21, 1941) ("An important feature of the rule is the extent to which it requires explicit and affirmative disclosure whenever a dividend is being paid from a capital source.").

6. By contract, Gabelli was responsible for the Funds' administrative operations during the relevant time period. The contract between Gabelli and The Gabelli Convertible and Income Securities Fund Inc. appoints Gabelli as the fund's investment manager and directs Gabelli to "oversee the administration of all aspects of the Fund's business and affairs and provide such services required for effective administration of the Fund." That agreement requires Gabelli to "oversee the performance of administrative and professional services rendered to the Fund of the Corporation by others including the Administrator, Custodian, Transfer Agent and Dividend Disbursing Agent, as well as legal, accounting and auditing services." Likewise, the contract between Gabelli and The Gabelli Utility Trust directs Gabelli "to oversee the administration of all aspects of the Fund's business and affairs and provide, or arrange for others whom it believes to be competent to provide" specified administrative functions.

7. In July 2001, Gabelli and the Funds jointly applied to the Commission for, and received, an exemption from Section 19(b) of the Investment Company Act to permit the Funds to distribute long-term capital gains throughout the year, instead of annually. In the exemptive application, Gabelli and the Funds represented that "[i]n accordance with Rule 19a-1 under the [Investment Company Act], a statement showing the source or sources of the distribution, i.e., net income, net short-term capital gains, net long-term capital gains and/or returns of capital accompanies or would accompany each distribution." Gabelli and the Funds also stated in the application that the disclosures accompanying the Funds' distributions would enable shareholders to understand that the fund payouts were not tied to the Funds' investment income.

8. During the relevant time period, the Funds made distributions to shareholders from shareholder capital and capital gains, as shown below annually on a per share basis.

Convertible and Income Securities Fund Inc.	2002 %	2002 $	2003 %	2003 $
Net Investment Income	36%	$.2717	24%	$.1880
Capital Gains	-	-	6%	$.0516
Shareholder Capital	64%	$.4783	70%	$.5604

Gabelli Utility Trust	2002 %	2002 $	2003 %	2003 $
Net Investment Income	15.5%	$.11175	12%	$.08544
Capital Gains	50%	$.3611	31%	$.22368
Shareholder Capital	34.5%	$.2469	57%	$.41088

9. During 2002, a portion of all of The Gabelli Convertible and Income Securities Fund Inc.'s quarterly distributions were paid from shareholder capital, while in 2003, portions of three of the four quarterly distributions of The Gabelli Convertible and Income Securities Fund

Inc.'s quarterly distributions were paid from shareholder capital and capital gains.[5] During 2002 and 2003, portions of all twenty-four of The Gabelli Utility Trust's monthly distributions were paid from shareholder capital and capital gains.[6] However, none of these distributions by the Funds was accompanied by notices informing shareholders that such payments were from shareholder capital and capital gains. Gabelli only issued quarterly press releases for the Funds in 2002 and 2003 that failed to provide any information regarding the source of the Funds' distributions for the relevant quarter.[7]

10. By paying distributions to shareholders from sources other than net income without disclosing the source of those distributions in a notice that accompanied the distributions, the Funds violated Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1.

11. Gabelli knew or was reckless in not knowing that the Funds were paying distributions to shareholders from sources other than the Funds' net income. In advance of the Board of Director meetings for the Funds in 2002 and 2003, Gabelli received detailed information regarding the Funds' distributions, including materials showing that these distributions would exceed the Funds' projected net income for the relevant quarter and characterizing portions of these distributions as "return of capital." Moreover, Gabelli closely tracked the Funds' performance on a book and tax basis and knew that the Funds regularly paid distributions from sources other than net income. Nevertheless, Gabelli, which was responsible for the Funds' administrative functions and had explicitly represented to the Commission that the Funds' distributions would be accompanied by Rule 19a-1 notices, failed to provide such contemporaneous notices containing the information required by Section 19(a) and Rule 19a-1 during 2002 and 2003.

12. As a result of the conduct described above, Gabelli caused and willfully aided and abetted the Funds' violations of Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1.

Respondent's Cooperation and Remedial Efforts

13. In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent.

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[5] Out of total distributions paid of $6,110,659 in 2002 for The Gabelli Convertible and Income Securities Fund Inc., $3,885,345 was from shareholder capital; for 2003, out of total distributions paid of $8,985,195, $340,383 was from capital gains and $6,705,640 was from shareholder capital.

[6] Out of total distributions paid of $9,496,830 in 2002 for the Gabelli Utility Trust, $4,760,629 was from capital gains and $3,261,058 was from shareholder capital; for 2003, out of total distributions paid of $12,348,980, $3,836,119 was from capital gains and $7,047,175 was from shareholder capital.

[7] During the relevant period, both funds provided shareholders with Internal Revenue Service Forms 1099-DIV that identified the source of the shareholders' distributions for the prior calendar year. In addition, both Funds' annual reports, posted on Gabelli's website, identified the source of distributions made by the Funds. Such notices did not comply with Section 19(a) and Rule 19a-1 because they were not made contemporaneously with each distribution.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Sections 9(b) and 9(f) of the Investment Company Act and Section 203(e) of the Advisers Act that:

A. Gabelli shall cease and desist from causing any violations and any future violations of Section 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1; and

B. Gabelli shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $450,000 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 Gabelli Funds, LLC 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 Christopher R. Conte, Esq., Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-4628.

By the Commission.

Elizabeth M. Murphy
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 Act of 1933
Release No. 8997 / January 12, 2009

Administrative Proceeding
File No. 3-13332

In the Matter of **Gabelli Funds, LLC,** **Respondent.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION**

I.

Gabelli Funds, LLC ("Gabelli"") has submitted two letters, dated July 1, 2008 and September 15, 2008, each requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from two separate orders entered by the Commission.

II.

On April 24, 2008, pursuant to Gabelli's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sections and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order I") against Gabelli. The Commission found that Gabelli permitted a United Kingdom hedge fund investment adviser ("U.K. manager") to market time a mutual fund managed by Gabelli in exchange for the U.K. manager's investment in a hedge fund advised by a Gabelli affiliate. The Commission concluded that as a result of such conduct Gabelli willfully violated Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"), Section 17(d) of the Investment Company Act of 1940 ("Investment Company Act") and Rule 17d-1 thereunder, and willfully aided and abetted and caused violations of Section 12(d)(1)(B)(i) of the Investment Company Act. The Commission censured Gabelli and required, among other things, Gabelli to pay a total of approximately $16 million in disgorgement and civil penalties.

On January 12, 2009, pursuant to Gabelli's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to

Section 203(e) of the Investment Advisers Act of 1940 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 ("Order II") against Gabelli. The Commission found that Gabelli caused and willfully aided and abetted violations of Scction 19(a) of the Investment Company Act and Investment Company Act Rule 19a-1 by two closed-end funds managed by Gabelli for failing to provide Rule 19a-1 notices to accompany those funds' thirty-one distributions during 2002 and 2003 which included shareholder capital and capital gains. The Commission ordered Gabelli to pay a civil money penalty of $450,000.

III.

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for the securities issued by small business investment companies and business development companies. The Regulation E exemption is not available for the securities of an issuer if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 203(e) of the Advisers Act. *See* Rule 602(c)(3) under the Securities Act. The Commission may waive the disqualification upon a showing of good cause. *See* Rule 602(e) under the Securities Act.

IV.

Based upon the representations set forth in Gabelli's requests, the Commission has determined that pursuant to Rule 602(e) a showing of good cause has been made such that Gabelli's requests for waivers of disqualification should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that waivers from the application of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of Order I and Order II is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

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

Commissioner Walter not participating

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59240 / January 13, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13339

In the Matter of KEVIN J. HERON, Respondent.	ORDER INSTITUTING PUBLIC 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 Kevin J. Heron ("Respondent" or "Heron") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent 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, and the findings contained in Section III(3) below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the

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 . . . attorney . . . who has been by name . . . [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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. Respondent Heron, 49, was the former general counsel, corporate secretary, and chief insider trading compliance officer for Amkor Technology, Inc. ("Amkor"), a technology company headquartered in Chandler, Arizona.

2. Amkor was, during the time period of the allegations charged in the complaint, a technology company with its headquarters in West Chester, Pennsylvania. In 2005, Amkor moved its headquarters to Chandler, Arizona. Amkor provides semiconductor assembly and test services. At all relevant times, the common stock of Amkor was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the NASDAQ.

3. On January 9, 2009, the U.S. District Court for the Eastern District of Pennsylvania entered a final judgment by consent against Heron, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 and permanently prohibiting him from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)]. Securities and Exchange Commission v. Kevin J. Heron, Civil Action Number 07-1542 (E.D. Pa.). Heron also was ordered by the court to pay $75,000 in disgorgement.

4. The complaint alleges that from October 2003 through June 2004, Heron repeatedly engaged in insider trading by purchasing and/or selling Amkor securities prior to five Amkor public announcements relating to earnings results or company business transactions. The complaint further alleges that during this period, Heron executed more than fifty illegal trades in Amkor common stock and option contracts on the basis of material, nonpublic information that Heron had learned in his position as general counsel of Amkor. The complaint also alleges that Heron executed nearly all of these illegal trades while he and other company employees were subject to blackout periods imposed by Amkor that prohibited trading in Amkor 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's Offer.

Accordingly, IT IS HEREBY ORDERED, effective immediately, that Heron is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.

Elizabeth M. Murphy
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. 59242 / January 13, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2829 / January 13, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13341

In the Matter of **Paul G. Risoli,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Paul G. Risoli ("Risoli" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Risoli, 49 years old, is a resident of New York, New York.

2. From June 2003 through February 2007, Risoli was a registered representative associated with Banc of America Securities LLC ("Banc of America"), a broker-dealer and investment adviser registered with the Commission.

3. On August 2, 2007, Risoli pled guilty to one count of conspiracy to commit wire fraud, in violation of Title 18, United States Code, Sections 1343 and 1346, and commercial bribery and commercial bribe receiving, in violation of the laws of the State of New York and in violation of Title 18, United States Code, Section 1952(a)(3), and one count of wire fraud, in violation of Title 18, United States Code, Sections 1343 and 1346, before the United States District Court for the Southern District of New York, in United States v. Paul Risoli, Crim. Indictment No. 1:07-CR-145.

4. The counts of the criminal indictment to which Risoli pled guilty alleged, inter alia, that Risoli caused Banc of America to allocate stock from certain initial public offerings and secondary offerings to Q Capital Investment Partners, LP ("Q Capital") in exchange for Q Capital paying Risoli cash kickbacks.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Risoli be, and hereby is barred from association with any broker, dealer, or investment adviser, 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.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 13, 2009

IN THE MATTER OF **The JPM Company, and** **Tidalwave Holdings, Inc.,** **File No. 500-1**	:	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of The JPM Company because it has not filed any periodic reports since the period ended June 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tidalwave Holdings, Inc. because it has not filed any periodic reports since the period ended December 31, 2000.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 13, 2009, through 11:59 p.m. EST on January 27, 2009.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 13, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13336

In the Matter of The JPM Company, Maxxis Group, Inc., Metrotrans Corp., and Tidalwave Holdings, Inc., Respondents.	ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against The JPM Company, Maxxis Group, Inc., Metrotrans Corp, and Tidalwave Holdings, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The JPM Company (CIK No. 1007581) is a Pennsylvania corporation located in Lewisburg, Pennsylvania with a class of securities registered pursuant to Exchange Act Section 12(g). JPM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2001, which reported a net loss of $22 million for the prior nine months. As of January 9, 2008, JPM's common stock symbol ("JPMX") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

2. Maxxis Group, Inc. (CIK No. 1045703) is a Georgia corporation located in Tucker, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Maxxis Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2002, which reported a net loss of $734,000 for the prior nine months.

3. Metrotrans Corp. (CIK No. 920464) is an administratively dissolved Georgia corporation located in Griffin, Georgia with a class of securities registered pursuant to Exchange Act Section 12(g). Metrotrans is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended October 3, 1999, which reported a net loss of $16 million for the prior nine months.

4. Tidalwave Holdings, Inc. (CIK No. 1038792) is a Florida corporation located in Clearwater, Florida with a class of securities registered pursuant to Exchange Act Section 12(g). Tidalwave Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2000, which reported a net loss of $137,549 for the prior nine months. On October 5, 2007, Tidalwave Holdings filed a Form 15 to terminate the registration of its securities under Exchange Act Rule 12(g)-4(a)(2)(i). The Form 15 is invalid on its face because the approximate number of shareholders listed is in excess of the permissible number of shareholders allowed by Rule 12(g)-4(a)(2)(i). As of January 9, 2008, Tidalwave Holding's common stock symbol ("TWVH") was quoted on the Pink Sheets, had thirteen market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Attachment

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Appendix 1

Chart of Delinquent Filings
The JPM Company, et al.

Company Name	*Form Type*	*Period Ended*	*Due Date*	*Date Received*	*Months Delinquent (rounded up)*
The JPM Company					
	10-K	09/30/01	12/31/01	Not filed	85
	10-Q	12/31/01	02/14/02	Not filed	83
	10-Q	03/31/02	05/15/02	Not filed	80
	10-Q	06/30/02	08/14/02	Not filed	77
	10-K	09/30/02	12/30/02	Not filed	73
	10-Q	12/31/02	02/14/03	Not filed	71
	10-Q	03/31/03	05/15/03	Not filed	68
	10-Q	06/30/03	08/14/03	Not filed	65
	10-K	09/30/03	12/29/03	Not filed	61
	10-Q	12/31/03	02/17/04	Not filed	59
	10-Q	03/31/04	05/17/04	Not filed	56
	10-Q	06/30/04	08/16/04	Not filed	53
	10-K	09/30/04	12/29/04	Not filed	49
	10-Q	12/31/04	02/14/05	Not filed	47
	10-Q	03/31/05	05/16/05	Not filed	44
	10-Q	06/30/05	08/15/05	Not filed	41
	10-K	09/30/05	12/29/05	Not filed	37
	10-Q	12/31/05	02/14/06	Not filed	35
	10-Q	03/31/06	05/15/06	Not filed	32
	10-Q	06/30/06	08/14/06	Not filed	29
	10-K	09/30/06	12/29/06	Not filed	25
	10-Q	12/31/06	02/14/07	Not filed	23
	10-Q	03/31/07	05/15/07	Not filed	20
	10-Q	06/30/07	08/14/07	Not filed	17
	10-K	09/30/07	12/29/07	Not filed	13
	10-Q	12/31/07	02/14/08	Not filed	11
	10-Q	03/31/08	05/15/08	Not filed	8
	10-Q	06/30/08	08/14/08	Not filed	5
Total Filings Delinquent	**28**				
Maxxis Group, Inc.					
	10-K	06/30/02	09/30/02	Not filed	76
	10-Q	09/30/02	11/14/02	Not filed	74
	10-Q	12/31/02	02/14/03	Not filed	71
	10-Q	03/31/03	05/15/03	Not filed	68
	10-K	06/30/03	09/29/03	Not filed	64

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Maxxis Group, Inc.					
	10-Q	09/30/03	11/14/03	Not filed	62
	10-Q	12/31/03	02/17/04	Not filed	59
	10-Q	03/31/04	05/17/04	Not filed	56
	10-K	06/30/04	09/28/04	Not filed	52
	10-Q	09/30/04	11/15/04	Not filed	50
	10-Q	12/31/04	02/14/05	Not filed	47
	10-Q	03/31/05	05/16/05	Not filed	44
	10-K	06/30/05	09/28/05	Not filed	40
	10-Q	09/30/05	11/14/05	Not filed	38
	10-Q	12/31/05	02/14/06	Not filed	35
	10-Q	03/31/06	05/15/06	Not filed	32
	10-K	06/30/06	09/28/06	Not filed	28
	10-Q	09/30/06	11/14/06	Not filed	26
	10-Q	12/31/06	02/14/07	Not filed	23
	10-Q	03/31/07	05/15/07	Not filed	20
	10-K	06/30/07	09/28/07	Not filed	16
	10-Q	09/30/07	11/14/07	Not filed	14
	10-Q	12/31/07	02/14/08	Not filed	11
	10-Q	03/31/08	05/15/08	Not filed	8
	10-K	06/30/08	09/29/08	Not filed	4
Total Filings Delinquent	**25**				
Metrotrans Corp.					
	10-K	12/31/99	03/30/00	Not filed	106
	10-Q	04/02/00	05/17/00	Not filed	104
	10-Q	07/02/00	08/16/00	Not filed	101
	10-Q	10/01/00	11/15/00	Not filed	98
	10-K	12/31/00	04/02/01	Not filed	93
	10-Q	04/01/01	05/16/01	Not filed	92
	10-Q	07/01/01	08/15/01	Not filed	89
	10-Q	09/30/01	11/14/01	Not filed	86
	10-K	12/31/01	04/01/02	Not filed	81
	10-Q	03/31/02	05/16/02	Not filed	80
	10-Q	06/30/02	08/15/02	Not filed	77
	10-Q	09/29/02	11/14/02	Not filed	74
	10-K	12/31/02	03/31/03	Not filed	70
	10-Q	03/30/03	05/14/03	Not filed	68
	10-Q	06/29/03	08/13/03	Not filed	65
	10-Q	09/28/03	11/12/03	Not filed	62
	10-K	12/31/03	03/30/04	Not filed	58
	10-Q	03/28/04	05/12/04	Not filed	56
	10-Q	06/27/04	08/11/04	Not filed	53

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Metrotrans Corp.					
	10-Q	09/26/04	11/10/04	Not filed	50
	10-K	12/31/04	03/31/05	Not filed	46
	10-Q	03/27/05	05/11/05	Not filed	44
	10-Q	06/26/05	08/10/05	Not filed	41
	10-Q	09/25/05	11/09/05	Not filed	38
	10-K	12/31/05	03/31/06	Not filed	34
	10-Q	03/26/06	05/10/06	Not filed	32
	10-Q	06/25/06	08/09/06	Not filed	29
	10-Q	09/24/06	11/08/06	Not filed	26
	10-K	12/31/06	03/31/07	Not filed	22
	10-Q	03/25/07	05/09/07	Not filed	20
	10-Q	06/24/07	08/08/07	Not filed	17
	10-Q	09/30/07	11/14/07	Not filed	14
	10-K	12/31/07	03/30/08	Not filed	10
	10-Q	03/30/08	05/14/08	Not filed	8
	10-Q	06/24/08	08/08/08	Not filed	5
	10-Q	09/30/08	11/14/08	Not filed	2
Total Filings Delinquent	**36**				
Tidalwave Holdings, Inc.					
	10-KSB	03/31/01	06/29/01	Not filed	91
	10-QSB	06/30/01	08/14/01	Not filed	89
	10-QSB	09/30/01	11/14/01	Not filed	86
	10-QSB	12/31/01	02/14/02	Not filed	83
	10-KSB	03/31/02	07/01/02	Not filed	78
	10-QSB	06/30/02	08/14/02	Not filed	77
	10-QSB	09/30/02	11/14/02	Not filed	74
	10-QSB	12/31/02	02/14/03	Not filed	71
	10-KSB	03/31/03	06/30/03	Not filed	67
	10-QSB	06/30/03	08/14/03	Not filed	65
	10-QSB	09/30/03	11/14/03	Not filed	62
	10-QSB	12/31/03	02/17/04	Not filed	59
	10-KSB	03/31/04	06/29/04	Not filed	55
	10-QSB	06/30/04	08/16/04	Not filed	53
	10-QSB	09/30/04	11/15/04	Not filed	50
	10-QSB	12/31/04	02/14/05	Not filed	47
	10-KSB	03/31/05	06/29/05	Not filed	43
	10-QSB	06/30/05	08/15/05	Not filed	41
	10-QSB	09/30/05	11/14/05	Not filed	38
	10-QSB	12/31/05	02/14/06	Not filed	35
	10-KSB	03/31/06	06/29/06	Not filed	31

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Tidalwave Holdings, Inc.					
	10-QSB	06/30/06	08/14/06	Not filed	29
	10-QSB	09/30/06	11/14/06	Not filed	26
	10-QSB	12/31/06	02/14/07	Not filed	23
	10-KSB	03/31/07	06/29/07	Not filed	19
	10-QSB	06/30/07	08/15/07	Not filed	17
	10-QSB	09/30/07	11/14/07	Not filed	14
	10-QSB	12/31/07	02/14/08	Not filed	11
	10-KSB	03/31/08	06/30/08	Not filed	7
	10-QSB	06/30/08	08/14/08	Not filed	5
	10-QSB	09/30/08	11/14/08	Not filed	2
Total Filings Delinquent	**31**				

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 13, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13337

In the Matter of **DIANE M. KEEFE,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Diane M. Keefe ("Respondent" or "Keefe").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent was associated with registered investment adviser Pax World Management Corp. from April 1999 through December 2007 and was also the portfolio manager of the Pax World High Yield Fund (a registered investment company) from April 1999 through October 2006. Respondent was a registered representative associated with broker-dealers registered with the Commission from March 1987 through August 1998, April 1999 through July 2006, and June 2007 through December 2007. Respondent, 50 years old, is a resident of Wilton, Connecticut.

B. OTHER RELEVANT ENTITIES

1. **Pax World Management Corp.** (SEC File No. 801-8517) ("Pax World") is a private Delaware corporation with its headquarters in Portsmouth, New Hampshire. Pax World has been an investment adviser registered with the Commission since 1972 and, at all relevant times, provided investment advisory services to the four Pax World Funds, each of which was an investment company registered with the Commission.

2. **Pax World High Yield Fund** (the "Fund") was established in 1999 and was a Delaware corporation headquartered in Portsmouth, New Hampshire, and was an investment company registered with the Commission. In 2007, the Fund changed its name to the Pax World High Yield Bond Fund.

C. KEEFE CREATED FALSE INVESTMENT COMMITTEE NOTES

1. For most of the period from 1999 through 2004 ("relevant period"), the Fund's prospectuses and proxy statements stated that the Fund had an investment committee made up of three individuals, including Keefe. The Fund's proxy statements for most of the period stated that the investment committee had the responsibility of overseeing the Fund's investments, that it met twice each year, and that Keefe and two other individuals served on the investment committee.[1] In fact, from 1999 until at least August 2003, these individuals never met as a group to discuss Fund investments.

2. In August 2003, Pax World's compliance liaison, located in Pax World's New Hampshire headquarters, asked Keefe for the notes of the Fund's investment committee meetings in connection with a routine examination being conducted by the Commission staff at that time.

3. Keefe knew that she and the two other individuals whom the Fund represented were members of the investment committee did not have any investment committee meetings during the period from 1999 through at least August 2003. Nevertheless, on August 13, 2003, she sent by facsimile from her office in New York to Pax World's headquarters a set of notes she had created and labeled "investment committee meeting" and represented them to be notes of nine Fund investment committee meetings that purportedly occurred from February 1999 to August 2003. These investment committee notes, which reflected investment advice, were false in that they consisted of notes of three-way conversations that never occurred. In fact, the date of the first purported meeting reflected in the notes Keefe created – February 2, 1999 – pre-dates Keefe's employment at Pax World by at least two months; those notes nonetheless represent that an investment committee meeting occurred and that Keefe was in attendance. The representations in the notes that the three members of the committee had met and discussed investments were untrue statements of a material fact.

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[1] The proxy statement filed June 8, 2000 stated that for 1999 the functions of the Fund's investment committee were performed by the management and officers of the Fund. This proxy statement does not indicate that the investment committee met in 1999.

4. Pax World's compliance liaison inserted these purported notes into Pax World's files for the Fund, which were available to the Commission's examination staff.

5. These false investment committee notes remained in the Fund's files maintained by Pax World for approximately one year.

D. VIOLATIONS

1. As a result of the conduct described above, Keefe willfully violated Section 34(b) of the Investment Company Act, which prohibits the making of any untrue statement of material fact in any document the keeping of which is required pursuant to Section 31(a). Rule 31a-1(b)(11) requires that every registered investment company maintain files of all advisory material received from the investment adviser, any advisory board or advisory committee, or any other persons from whom the investment company accepts investment advice. Keefe was a person from whom the Fund accepted investment advice and the investment committee notes constitute advisory material for purposes of Rule 31a-1(b)(11).

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9(d) of the Investment Company Act;

C. Whether, pursuant to Section 9(f) of the Investment Company Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 34(b) of the Investment Company Act;

D. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act; and

E. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against her upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230, 240 and 260

[Release Nos. 33-8999; 34-59246; 39-2549; File No. S7-02-09]

RIN 3235-AK26

TEMPORARY EXEMPTIONS FOR ELIGIBLE CREDIT DEFAULT SWAPS TO FACILITATE OPERATION OF CENTRAL COUNTERPARTIES TO CLEAR AND SETTLE CREDIT DEFAULT SWAPS

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rules; Request for comments.

SUMMARY: We are adopting interim final temporary rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for certain credit default swaps to facilitate the operation of one or more central counterparties for those credit default swaps. The interim final temporary rules define such credit default swaps as "eligible credit default swaps" and exempt them from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met. Our interim final temporary rules also define as a "qualified purchaser," for purposes of the "covered securities" provisions of Section 18 of the Securities Act, any "eligible contract participant," as defined in Section 1a(12) of the Commodity Exchange Act ("CEA"), other than a person who is an eligible contract participant under Section 1a(12)(C) of the CEA, to whom a sale of a eligible credit default swap is made in reliance on the interim final temporary Securities Act exemption.

DATES: Effective Date: The interim final temporary rules are effective [insert date of publication in the Federal Register] until September 25, 2009. Comment Date: Comments on the interim final temporary rules should be received on or before [insert date 60 days after date of 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/interim-final-temp.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-02-09 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-02-09. 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/interim-final-temp.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: Amy M. Starr, Senior Special Counsel, or Kim McManus, Special Counsel, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adopting interim final temporary Rule 239T and a temporary amendment to Rule 146 under the Securities Act of 1933 ("Securities Act").[1] We are also adopting interim final temporary Rule 12a-10T and Rule 12h-1(h)T under the Securities Exchange Act of 1934 ("Exchange Act")[2] and interim final temporary Rule 4d-11T under the Trust Indenture Act of 1939 ("Trust Indenture Act").[3]

I. BACKGROUND

In response to the recent turmoil in the financial markets, we have taken multiple actions to protect investors and ensure the integrity of the nation's securities markets.[4] Today we are

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1 15 U.S.C. 77a et. seq.

2 15 U.S.C. 78a et. seq.

3 15 U.S.C. 77aaa et. seq.

4 A nonexclusive list of the Commission's actions to stabilize financial markets during this credit crisis include: adopting a package of measures to strengthen investor protections against naked short selling, including rules requiring a hard T+3 close-out, eliminating the options market maker exception of Regulation SHO, and expressly targeting fraud in short selling transactions (See Securities Exchange Act Release No. 58572 (September 17, 2008), 73 FR 54875 (September 23, 2008)); issuing an emergency order to enhance protections against naked short selling in the securities of primary dealers, Federal National Mortgage Association ("Fannie Mae"), and Federal Home Loan Mortgage Corporation ("Freddie Mac") (See Securities Exchange Act Release No. 58166 (July 15, 2008), 73 FR 42379 (July 21, 2008)); taking temporary emergency action to ban short selling in financial securities (See Securities Exchange Act Release No. 58592 (September 18, 2008), 73 FR 55169 (September 24, 2008)); approving emergency rulemaking to ensure disclosure of short positions by hedge funds and other institutional money managers (See Securities Exchange Act Release No. 58591A (September 21, 2008), 73 FR 55557 (September 25, 2008)); proposing rules to strengthen the regulation of credit rating agencies and making the limits and purposes of credit ratings clearer to investors (See Securities Exchange Act Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008); entering into a Memorandum of Understanding with the Board of Governors of the Federal Reserve System ("FRB") to make sure key federal financial regulators share information and coordinate regulatory activities in important areas of common interest (See Memorandum of Understanding Between the U.S. Securities and Exchange Commission and the Board of Governors of the Federal Reserve System Regarding Coordination and Information Sharing in Areas of Common Regulatory and Supervisory Interest (July 7, 2008), http://www.sec.gov/news/press/2008/2008-134_mou.pdf).

taking further action designed to address concerns related to the market in credit default swaps ("CDS"). The over-the-counter ("OTC") market for CDS has been a source of concerns to us and other financial regulators. These concerns include the systemic risk posed by CDS, highlighted by the possible inability of parties to meet their obligations as counterparties and the potential resulting adverse effects on other markets and the financial system.[5] Recent credit market events have demonstrated the seriousness of these risks in a CDS market operating without meaningful regulation, transparency,[6] or central counterparties ("CCPs").[7] These events have emphasized the need for CCPs as mechanisms to help control such risks.[8] A CCP for CDS could be an important step in reducing the counterparty risks inherent in the CDS market, and thereby help mitigate potential systemic impacts. In November 2008, the President's Working Group on Financial Markets stated that the implementation of a CCP for CDS was a top priority[9] and, in furtherance of this recommendation, the Commission, the FRB and the Commodity Futures Trading Commission ("CFTC") signed a Memorandum of Understanding[10] that

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5 In addition to the potential systemic risks that CDS pose to financial stability, we are concerned about other potential risks in this market, including operational risks, risks relating to manipulation and fraud, and regulatory arbitrage risks.

6 See Policy Objectives for the OTC Derivatives Market, The President's Working Group on Financial Markets (November 14, 2008), http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf ("Public reporting of prices, trading volumes and aggregate open interest should be required to increase market transparency for participants and the public.")

7 See The Role of Credit Derivatives in the U.S. Economy Before the H. Agric. Comm., 110th Cong. (2008) (Statement of Erik Sirri, Director of the Division of Trading and Markets, Commission).

8 See id.

9 See Policy Objectives for the OTC Derivatives Market, The President's Working Group on Financial Markets (November 14, 2008), http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf. See also Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (March 13, 2008), http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf; Progress Update on March Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (October 2008), http://www.treas.gov/press/releases/reports/q4progress%20update.pdf.

10 See Memorandum of Understanding Between the Board of Governors of the Federal Reserve System, the U.S. Commodity Futures Trading Commission and the U.S. Securities and Exchange Commission Regarding Central Counterparties for Credit Default Swaps (November 14, 2008), http://www.treas.gov/press/releases/reports/finalmou.pdf ("MOU").

establishes a framework for consultation and information sharing on issues related to CCPs for CDS. Given the continued uncertainty in this market, taking action to help foster the prompt development of CCPs, including granting conditional exemptions from certain provisions of the federal securities laws, is in the public interest. The interim final temporary rules we are adopting are intended to facilitate the ability of one or more CCPs for CDS to operate by providing exemptions from certain regulatory provisions that might otherwise prevent them from engaging in such activities.

A CDS is a bilateral contract between two parties, known as counterparties. The value of this financial contract is based on underlying obligations ("reference obligations") of a single entity (a "reference entity") or on a particular security or other debt obligation ("reference security"), or an index of several such entities, securities, or obligations. The obligation of a seller to make payments under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities. Investors may use CDS for a variety of reasons, including to offset or insure against risk in their fixed-income portfolios, to take synthetic positions in bonds or in segments of the debt market as represented by an index, or to capitalize on the volatility in credit spreads during times of economic uncertainty. In recent years, CDS market volumes have rapidly increased.[11] This growth has coincided with a significant rise in the types and number of entities participating in the CDS market.[12]

The operation of a well-regulated CCP can significantly reduce counterparty risks by preventing the failure of a single market participant from having a disproportionate effect on the

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11 See Semiannual OTC derivatives statistics at end-December 2007, Bank for International Settlements ("BIS"), available at http://www.bis.org/statistics/otcder/dt1920a.pdf.

12 CDS were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant with their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms and hedge funds have entered the CDS market.

overall market. A CCP would novate bilateral trades, which would result in the CCP entering into separate contractual arrangements with both counterparties – becoming buyer to one and seller to the other.[13] Today, CDS agreements generally are negotiated and entered into bilaterally, but both parties may agree that one party may novate the agreement and substitute another party to take responsibility for performance, by acting as the counterparty, under the agreement. In a CCP arrangement, both parties entering a CDS would novate their trades to the CCP, and the CCP would stand in as the counterparty to all parties of the CDS it clears. Through this novation process, the counterparty risk of a CDS would be effectively concentrated in the CCP.

In companion actions to these interim final temporary rules, we are temporarily exempting, subject to conditions, a clearing agency acting as a CCP from the requirement to register as a clearing agency under Section 17A of the Exchange Act[14] solely to perform the functions of a clearing agency for certain CDS transactions, and also certain eligible contract participants[15] and others from certain Exchange Act requirements with respect to certain CDS.[16] We also are temporarily exempting any exchange that effects transactions in certain CDS from the requirements under Sections 5 and 6 of the Exchange Act[17] to register as a national securities exchange, and any broker or dealer that effects transactions on an exchange in certain CDS from the requirements of Section 5 of the Exchange Act.

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13 "Novation" is a "process through which the original obligation between a buyer and seller is discharged through the substitution of the CCP as seller to buyer and buyer to seller, creating two new contracts." Committee on Payment and Settlement Systems, Technical Committee of the International Organization of Securities Commissioners, Recommendations for Central Counterparties (November 2004) at 66.

14 15 U.S.C. 78q-1.

15 See 7 U.S.C. 1a(12).

16 See Securities Exchange Act Release Nos. 59164 and 59165 (December 24, 2008).

17 15 U.S.C. 78e and 78f.

In connection with these actions to facilitate the operation of these CCPs for the CDS market, we believe that it is appropriate and necessary to provide temporary exemptions from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, subject to certain conditions described in the companion exemptive orders and in the exemptions themselves. We believe that these interim final temporary rules, and the exemptive orders we are providing under the Exchange Act, will facilitate the operation of one or more CCPs that will clear and settle CDS transactions while enabling us to provide oversight to the CDS market.

We believe that the operation of one or more CCPs in accordance with our exemptions likely would improve the efficiency and effectiveness of the CDS market, provide for increased transparency of exposures to particular reference entities or reference securities, and increase available information about reference entities or reference securities. The conditions in the companion exemptive orders will enable us to oversee the development of CDS CCPs and exchanges as they evolve, and to take such additional action as we may deem necessary to promote the public interest and the protection of investors. Moreover, the limited duration of the exemptions and the interim final temporary rules provided today will enable one or more CCPs and CDS exchanges to become operational while we gain useful experience with the CDS market and evaluate the public input, including comments, we receive on the temporary rules and exemptions.

II. DISCUSSION OF THE INTERIM FINAL TEMPORARY RULES AND AMENDMENTS

We are adopting interim final temporary rules and amendments to existing rules (collectively, "interim final temporary rules") to provide certain conditional exemptions under the Securities Act, the Exchange Act and the Trust Indenture Act.

A. Scope of the Interim Final Temporary Rules

Our authority over the OTC market for CDS is limited. Specifically, Section 2A of the Securities Act and Section 3A of the Exchange Act limit our authority over "swap agreements" as defined in Section 206A of the Gramm-Leach-Bliley Act.[18] For those CDS that are swap agreements, the exclusion from the definition of security in Section 2A of the Securities Act and Section 3A of the Exchange Act and related provisions will continue to apply. Our action today does not affect these CDS, and these interim final temporary rules do not apply to them. For those CDS that are not swap agreements ("non-excluded CDS"), our action today provides certain conditional exemptions from the provisions of the Securities Act, the Exchange Act, and the Trust Indenture Act and is designed to encourage the development and operation of one or more CDS CCPs and CDS exchanges.[19]

B. Securities Act Rule 239T

We are adopting interim final temporary Securities Act Rule 239T to exempt certain CDS ("eligible CDS")[20] that are being or will be issued or cleared by a CCP satisfying the conditions set forth in the companion exemptions, or registered as a clearing agency under Section 17A of

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18 15 U.S.C. 77b(b)-1 and 15 U.S.C. 78c-1. Section 2A of the Securities Act and Section 3A of the Exchange Act excludes both a non-security-based and a security-based "swap agreement" from the definition of "security" under Section 2(a)(1) of the Securities Act, 15 U.S.C. 77b(a)(1) and Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a "swap agreement" as "any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act. . .) . . . the material terms of which (other than price and quantity) are subject to individual negotiation. . . ." 15 U.S.C. 78c note.

19 Section 28 of the Securities Act authorizes us to exempt any person, security or transaction from any provision of the Securities Act by rule or regulation to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. 15 U.S.C. 77z-3. Similarly, Section 36 of the Exchange Act gives us the authority to exempt any person, security or transaction from any Exchange Act provision by rule, regulation or order, to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. 15 U.S.C. 78mm. Finally, Section 304(d) of the Trust Indenture Act authorizes us to exempt conditionally or unconditionally any person, security or transaction from any Trust Indenture Act provision by rules or regulation to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the Trust Indenture Act. 15 U.S.C. 77ddd(d).

20 As we discuss below, we have included a definition of "eligible credit default swap" in interim final temporary Securities Act Rule 239T.

the Exchange Act ("Registered or Exempt CCP"), to eligible contract participants from all provisions of the Securities Act, except the anti-fraud provisions of Section 17(a) of the Securities Act.[21] Securities Act Rule 239T will permit the offer and sale of such eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP without requiring compliance with Section 5 of the Securities Act, and communications used in connection with such offers and sales will not be subject to Section 12(a)(2) liability under the Securities Act.

Absent this exemption, the Securities Act may require registration of the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP. We believe that the interim final temporary rules exempting offers and sales of such eligible CDS by a Registered or Exempt CCP will facilitate the use by eligible contract participants of CCPs for eligible CDS. Indeed, without also exempting the offers and sales of the eligible CDS by a Registered or Exempt CCP from the registration requirements of the Securities Act and the Exchange Act and the provisions of the Trust Indenture Act, we believe that the CCPs would not be able to operate in the manner contemplated by the Exchange Act exemptive orders. In addition, the Securities Act, Exchange Act and Trust Indenture Act exemptions should encourage market participants to clear their CDS through the CCPs.

Under Securities Act Rule 239T, an eligible CDS would be exempt from the registration requirements of the Securities Act if it is or will be issued or cleared by a Registered or Exempt CCP, and if the eligible CDS is offered and sold only to an "eligible contract participant" (as defined in Section 1a(12) of the CEA as in effect on the date of adoption of this rule, other than a

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[21] 15 U.S.C. §77q. This exemption is consistent with the Securities Act exemptions for standardized options and security futures products. See Section 3(a)(14) [15 U.S.C. §77c(a)(14)] and Securities Act Rule 238 [17 CFR 230.238].

person who is an eligible contract participant under Section 1a(12)(C) of the CEA).[22] We have included a definition of eligible CDS solely for purposes of the interim final temporary rules. Under this definition, an eligible CDS is a bilateral executory derivative contract not subject to individual negotiation (1) in which a buyer makes payments to the seller and, in return, receives a payout if there is a default or other credit event involving the reference obligation(s) or reference entity(ies) within a certain time, and (2) the agreement for which includes the:

- specification of the reference obligation or obligor; or, in the case of a reference group or index thereof, all of the reference obligations or obligors comprising any such group or index);
- term of the agreement;
- notional amount upon which payment obligations are calculated;
- credit-related events that trigger a settlement obligation; and
- obligations to be delivered if there is a credit-related event or, if it is a cash settlement, the obligations whose value is to be used to determine the amount of settlement obligation under the eligible credit default swap.

Securities Act Rule 239T will permit the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP without requiring compliance with Section 5 of the Securities Act, while assuring the availability of information to buyers and sellers of CDS, due to certain information conditions in the companion exemptive orders,[23] and preserving anti-

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22 See 7 U.S.C. 1(a)(12). The exemption would be limited to those persons defined as eligible contract participants in the statute and would not extend to those persons that are included in the definition through regulatory action by the CFTC. See 7 U.S.C. 1(a)(12)(C).

23 We note that among the conditions of the exemptions, or representations in the exemptive requests on which we are relying, from clearing registration are that: (1) information is available about the terms of the CDS, the creditworthiness of the CCP or any guarantor, and the clearing and settlement process for the CDS; and (2) the reference entity, the issuer of the reference security, or the reference security is one of the following: an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4)

fraud liability under Sections 17(a) of the Securities Act, which currently applies to security-based swap agreements. Securities Act Rule 239T also provides an exemption from the liability provisions of Securities Act Section 12. Thus, oral or written communications used in connection with the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP in reliance on the rule will not be subject to liability under Securities Act Section 12(a)(2).

The Securities Act exemption in the interim final temporary rule is limited to offers and sales to eligible contract participants (as defined in Section 1a(12) of the CEA as in effect on the date of adoption of the rule, other than a person that is an eligible contract participant under Section 1a(12)(C) of the CEA). Under Securities Act Section 2A, a security-based swap agreement that is entered into between eligible contract participants is not permitted to be registered under the Securities Act, but the provisions of Securities Act Section 17(a) continue to apply to such transactions. The operation of one or more CCPs pursuant to the actions we are taking today will allow such security-based swap agreements to continue to be entered into between eligible contract participants and then be novated to the CCP. The Securities Act exemption is intended to limit investor involvement in eligible CDS that are issued or cleared by a Registered or Exempt CCP to eligible contract participants, who are those persons Congress determined were qualified to engage in activities in the generally unregulated (other than with

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information, or about which financial information is otherwise publicly available; a foreign private issuer that has securities listed outside the United States and has its principal trading market outside the United States; a foreign sovereign debt security; an asset-backed security, as defined in Regulation AB [17 CFR 229.1100], issued in a registered transaction with publicly available distribution reports; an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or the Government National Mortgage Association ("Ginnie Mae"); or indexes in which 80 percent or more of the index's weight is comprised of these reference entities or reference securities.

respect to the antifraud provisions of the Securities Act and the Exchange Act)[24] OTC CDS market.

The Securities Act interim final temporary rule also provides that any offer or sale of an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP by or on behalf of the issuer of a security, an affiliate of such issuer, or an underwriter, if such security is delivered in settlement or whose value is used to determine the amount of the settlement obligation, will constitute a "contract for sale of," "sale of," "offer for sale," or "offer to sell" such security under Section 2(a)(3) of the Securities Act. This provision is intended to ensure that an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP cannot be used by an issuer, affiliate of an issuer or underwriter to circumvent the registration requirements of Section 5 with respect to an issuer's security for such eligible CDS.[25] As a result, a transaction by such persons in an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP having such securities of the issuer also is a transaction in the issuer's securities that must be registered under the Securities Act, unless an exemption from registration is available.

Further, we are adopting on an interim final temporary basis an amendment to Securities Act Rule 146. Under the temporary amendment to Securities Act Rule 146, eligible contract participants that are sold eligible CDS in reliance on interim final temporary Securities Act Rule

24 See Title III of the Commodity Futures Modernization Act of 2000 (Pub. L. 106-554) and the definition of eligible contract participant in Title I of the Commodity Futures Modernization Act of 2000 [7 U.S.C. 1a(12)]. The term "eligible contract participant" generally includes various regulated financial institutions, business enterprises that meet certain tests relating to total assets or net worth, certain pension funds, state and local governments, and certain wealthy individuals.

In addition, the provisions of Section 16 of the Exchange Act apply to security-based swap agreements. See 15 U.S. C. 78p(g). The exemptions are available only with regard to non-excluded CDS satisfying the exemption's conditions and not other types of derivative contracts.

25 This provision is similar to the condition in the Securities Act exemption in Rule 238 for standardized options [17 CFR 230.238] and in Securities Act Section 2(a)(3) [15 U.S.C. 77b(a)(3)] relating to security futures products.

239T will be defined as "qualified purchasers" under Section 18(b)(3) of the Securities Act and thereby such eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP will be considered "covered securities" under Section 18 of the Securities Act and exempt from state blue sky laws.[26] We are adopting this amendment because we believe that eligible contract participants are the kinds of sophisticated investors who do not require the protections of registration under state securities laws. In this regard, as we discuss above, Congress determined that eligible contract participants were the types of persons that were able to engage in activities in the OTC CDS market unregulated by the Commission and preempted the application of certain state laws to transactions in OTC security-based swap agreements, including CDS.[27] We believe that defining such eligible contract participants as "qualified purchasers" for purposes of engaging in transactions in eligible CDS in reliance on temporary Securities Act Rule 239T would be consistent with such Congressional intent.

C. Exchange Act Rule 12a-10T and Rule 12h-1(h)T

We also are adopting two interim final temporary rules relating to Exchange Act registration of eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP. We are adopting interim final temporary Exchange Act Rule 12a-10T to exempt eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP from the provisions of Section 12(a) of the Exchange Act under certain conditions.[28] We also are adopting an interim final temporary amendment to Exchange Act Rule 12h-1 to exempt eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP from the provisions of Section 12(g) of

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26 State securities regulation of covered securities generally is limited under Section 18(b). Under Section 18(b)(3), covered securities are securities offered and sold to qualified purchasers, as defined by the Commission.

27 See 7 U.S.C. 16(e)(2).

28 15 U.S.C. 78l(a).

the Exchange Act under certain conditions.[29] This exemption is the same as that available to standardized options issued by a registered options clearing agency and security futures products issued by a registered clearing agency, and this temporary rule should facilitate the operation of the CCPs.

D. Trust Indenture Act Rule 4d-11T

We are adopting a new interim final temporary rule under Section 304(d) of the Trust Indenture Act that would exempt any eligible CDS, as defined in Securities Act Rule 239T and offered and sold in reliance on Securities Act Rule 239T, from having to comply with the provisions of the Trust Indenture Act.[30] We believe an exemption from the Trust Indenture Act is appropriate in this situation.

The Trust Indenture Act is aimed at addressing problems that unregulated debt offerings posed for investors and the public,[31] and provides a mechanism for debtholders to protect and enforce their rights with respect to the debt. We do not believe that the protections contained in the Trust Indenture Act are needed at this time to protect eligible contract participants to whom a sale of an eligible CDS is made in reliance on interim final temporary Securities Act Rule 239T. The identified problems that the Trust Indenture Act is intended to address do not occur in the offer and sale of eligible CDS.[32] For example, eligible CDS are contracts between two parties and, as a result, do not raise the same problem regarding the ability of parties to enforce their

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29 15 U.S.C. 78l(g).

30 The Trust Indenture Act applies to debt securities sold through the use of the mails or interstate commerce. Section 304 of the Trust Indenture Act exempts from the Act a number of securities and transactions. Section 304(a) of the Trust Indenture Act exempts securities that are exempt under Securities Act Section 3(a) but does not exempt from the Trust Indenture Act securities that are exempt by Commission rule. Accordingly, while Securities Act Rule 239T would exempt the offer and sale of eligible CDS satisfying certain conditions from all the provisions of the Securities Act (other than Section 17(a)), the Trust Indenture Act would continue to apply.

31 <u>See</u> 15 U.S.C.77bbb(a).

32 15 U.S.C. 77bbb(a).

rights under the instruments as would, for example, a debt offering to the public. Moreover, through novation, the CCP becomes the counterparty to the buyer and the seller, and each would look directly to the CCP to satisfy the obligations under the eligible CDS. As a consequence, enforcement of contractual rights and obligations under the eligible CDS would occur directly between such parties, and the Trust Indenture Act provisions would not provide any additional meaningful substantive or procedural protections.

Accordingly, due to the nature of eligible CDS as bilateral contracts that will have been issued or cleared by Registered or Exempt CCPs, we do not believe the protections contained in the Trust Indenture Act are currently needed with respect to these instruments. Therefore, we believe the exemption is necessary or appropriate in the public interest, consistent with the protection of investors and the purposes fairly intended by the Trust Indenture Act.

E. Request for Comment

We request and encourage any interested person to submit comments regarding the interim final temporary rules. In particular, we solicit comment on the following questions:

- We are interested in understanding what type of non-excluded CDS would not be eligible for these exemptions. Are there credit swaps that would not be encompassed within the scope of the exemptions and that should be covered?
- What are the amounts and types of CDS that may not satisfy the conditions for the exemptions?
- Is the definition of eligible CDS appropriate and does it include the types of CDS that should be within the exemptions or should there be another definition? Does the definition of eligible CDS include all the appropriate or relevant material terms of a

CDS? Should we require more specificity as to the terms, including final settlement valuations?

- Each of the temporary exemptions contains particular conditions. Should the Securities Act exemption in temporary Securities Act Rule 239T be conditioned on the eligible CDS being issued or cleared by a Registered or Exempt CCP? If not, why not?
- Should there be information conditions in the Securities Act exemptions themselves regarding the reference entities or reference securities similar to the information requirements in the CCP exemptive orders? If so, what type of information conditions should be included and why? Is additional or different information from that contained in the CCP exemption orders appropriate?
- Are the Securities Act, Exchange Act and Trust Indenture Act exemptions appropriate? If not, why not? Given the voluntary nature of using a CCP, should we take a different approach?
- The Securities Act exemption also provides that eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP and are entered into with an issuer of a security, or an underwriter or affiliate of such issuer, if such security is delivered in settlement or whose value is used to determine the amount of the settlement obligation, will be considered an offer and sale of such security at that time. Are there circumstances in which the application of the Securities Act to such security of the issuer should not apply at the time of the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP? Are there securities or

obligations used in CDS transactions that are not debt obligations? If yes, please explain.

- The Securities Act exemption is limited to offers and sales to eligible contract participants. Should the exemption be limited in this manner? If not, why not? Are there persons who invest in CDS now in the OTC market that would not be able to take advantage of the exemptions? If yes, please explain the categories of persons and why the exemptions should include such persons.
- The definition of "qualified purchaser" for purposes of the interim final temporary amendment to Securities Act Rule 146 applies only to eligible contract participants that have been sold eligible CDS in reliance on the new interim final temporary exemption in Securities Act Rule 239T. Is this an appropriate definition and should eligible contract participants that are sold eligible CDS pursuant to Securities Act Rule 239T be considered "qualified purchasers" for purposes of Section 18 of the Securities Act?
- Should the Securities Act exemption be limited to an exemption from Section 5 and Section 12 of the Securities Act? Please explain your reasoning in detail.
- Should we exempt eligible CDS that have been issued or cleared by a Registered or Exempt CCP from the registration requirements of the Exchange Act? If not, why?
- The conditions of the temporary Exchange Act and Trust Indenture Act exemptions are the same as the conditions to the temporary Securities Act exemption. Is this appropriate or should there be different conditions relating to the Exchange Act and Trust Indenture Act exemptions? If yes, please explain.

- The interim final temporary rules include an exemption from the application of the Trust Indenture Act for eligible CDS that are offered and sold in reliance on interim final Securities Act Rule 239T. Is this exemption appropriate or are there contractual protections in the Trust Indenture Act that should be included as mandatory provisions of an eligible CDS contract that is or will be issued or cleared by a Registered or Exempt CCP? If yes, please explain in detail.

III. TRANSITION AND EXPIRATION DATE OF INTERIM FINAL TEMPORARY RULES

We are adopting the interim final rules on a temporary basis until September 25, 2009. We anticipate that this term of this exemption will provide us with adequate time to evaluate the availability of the exemptions applicable to CDS CCPs and non-excluded CDS, and whether any conditions or provisions of such exemptions should be modified.

Adoption of the interim final temporary rules, which will be effective on [effective date] and will continue in effect until September 25, 2009, will facilitate the development of one or more CCPs as well as our review of the CDS market. We have included several requests for comment in this release. We will consider the public comments we receive in determining whether we should revise the interim final temporary rules in any respect, as well as whether we should consider extending the exemptions. The rules will expire and cease to be effective on September 25, 2009 unless we act to extend the effective date or revise the interim final temporary rules.

IV. OTHER MATTERS

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.[33] 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."[34] 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.[35] This requirement does not apply, however, if the agency finds good cause for making the rule effective sooner.[36] We, for good cause, find that notice and solicitation of comment before adopting the new rules 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 these rules on an interim final temporary basis. The OTC market for CDS has been a source of concerns to us and other financial regulators. These concerns include the systemic risk posed by CDS, highlighted by the possible inability of parties to meet their obligations as counterparties and the potential resulting adverse effects on other markets and the financial system.[37] Recent credit market events have demonstrated the seriousness of these risks in a CDS market operating without meaningful regulation, transparency,[38] or CCPs.[39]

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33 See 5 U.S.C. 553(b).

34 Id.

35 See 5 U.S.C. 553(d).

36 Id.

37 In addition to the potential systemic risks that CDS pose to financial stability, we are concerned about other potential risks in this market, including operational risks, risks relating to manipulation and fraud, and regulatory arbitrage risks.

38 See Policy Objectives for the OTC Derivatives Market, The President's Working Group on Financial Markets (November 14, 2008), http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf ("Public reporting of prices, trading volumes and aggregate open interest should be required to increase market transparency for participants and the public.")

39 See The Role of Credit Derivatives in the U.S. Economy Before the H. Agric. Comm., 110th Cong. (2008) (Statement of Erik Sirri, Director of the Division of Trading and Markets, Commission).

These events have emphasized the need for CCPs as mechanisms to help control such risks.[40] A CCP for CDS could be an important step in reducing the counterparty risks inherent in the CDS market, and thereby help mitigate potential systemic impacts. In November 2008, the President's Working Group on Financial Markets stated that the implementation of a CCP for CDS was a top priority[41] and, in furtherance of this recommendation, the Commission, the FRB and the CFTC signed a Memorandum of Understanding[42] that establishes a framework for consultation and information sharing on issues related to CCPs for CDS. Given the continued uncertainty in this market, taking action to help foster the prompt development of CCPs, including granting conditional exemptions from certain provisions of the federal securities laws, thus is in the public interest. The interim final temporary rules we are adopting are intended to facilitate the ability of one or more CCPs for CDS to operate by providing exemptions from certain regulatory provisions that might otherwise prevent them from engaging in such activities. Absent an exemption, the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP may have to be registered under the Securities Act, the eligible CDS that have been so issued or cleared may have to be registered as a class under the Exchange Act and the provisions of the Trust Indenture Act may need to be complied with. We believe that the interim final temporary rules exempting the registration of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP under certain conditions will facilitate the use by eligible contract participants of CDS CCPs. Without also exempting the offers and sales of the

40 See id.

41 See Policy Objectives for the OTC Derivatives Market, The President's Working Group on Financial Markets (November 14, 2008), http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf. See also Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (March 13, 2008), http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf; Progress Update on March Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (October 2008), http://www.treas.gov/press/releases/reports/q4progress%20update.pdf.

42 See MOU, supra note 10.

eligible CDS from the registration requirements of the Securities Act and the Exchange Act and the provisions of the Trust Indenture Act, we believe that the CCPs would not be able to operate in the manner contemplated by the exemptive orders. We emphasize that we are requesting comments on the interim final temporary rules and will carefully consider any comments that we receive and respond to them in a subsequent release. Moreover, these interim final temporary rules will expire on September 25, 2009. Setting a termination date for the interim final temporary rules will necessitate further Commission action no later than the end of that period if we determine to continue the same, or similar, requirements contained in the interim final temporary rules. We find that there is good cause to have the rules effective as interim final temporary rules on [insert date of publication in the Federal Register] and that notice and public procedure in advance of effectiveness of the interim final temporary rules is impracticable, unnecessary and contrary to the public interest.[43]

V. PAPERWORK REDUCTION ACT

The interim final temporary rules do not impose any new "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"),[44] nor do they create any new filing, reporting, recordkeeping, or disclosure reporting requirements for a CCP that is or will be issuing or clearing eligible CDS. Accordingly, we are not submitting the interim final temporary rules to the Office of Management and Budget for review in accordance with the PRA.[45] We request comment on whether our conclusion that there are no collections of information is correct.

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43 This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rule amendment 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").

44 44 U.S.C. 3501 et seq.

45 44 U.S.C. 3507(d) and 5 CFR 1320.11.

VI. COST-BENEFIT ANALYSIS

We are adopting interim final temporary rules under the Securities Act, the Exchange Act and the Trust Indenture Act that would exempt eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP and offered and sold only to eligible contract participants from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and from the provisions of the Trust Indenture Act. These interim final temporary rules are intended to facilitate the operation of one or more CCPs to act as a clearing agency in the CDS market to reduce some of the risks in the CDS market.

A CDS is a bilateral contract between two parties, known as counterparties. The value of this financial contract is based on underlying obligations of a single entity or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller to make payment under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities. Investors may use CDS for a variety of reasons, including to offset or insure against risk in their fixed-income portfolios, to take synthetic positions in bonds or in segments of the debt market as represented by an index, or to capitalize on the volatility in credit spreads during times of economic uncertainty. In recent years, CDS market volumes have rapidly increased.[46] This growth has coincided with a significant rise in the types and number of entities participating in the CDS market.[47]

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46 See Semiannual OTC derivatives statistics at end-December 2007, Bank for International Settlements ("BIS"), available at http://www.bis.org/statistics/otcder/dt1920a.pdf.

47 CDSs were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant with their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms and hedge funds have entered the CDS market.

In a CCP arrangement, both parties entering a CDS would novate their trades to the CCP, and the CCP would stand in as the counterparty to all parties of the CDS it clears. Through this novation process, the counterparty risk of a CDS would be effectively concentrated in the CCP.

A. Benefits

We are providing exemptive orders that will facilitate the operation of CCPs for the CDS market. In connection with these actions, we are adopting exemptions from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, subject to certain conditions described in the companion exemptive orders and in the exemptions themselves. The conditions and representations in the companion exemptive orders and exemptions require that information be available about the terms of the CDS, the creditworthiness of the CCP or any guarantor, and the clearing and settlement process for the CDS. Additionally, the conditions require that financial information about the reference entity, the issuer of the reference security, or the reference security be publicly available. We believe that these interim final temporary rules and the exemptions we are providing under the Exchange Act, will facilitate the operation of CCPs while enabling us to provide oversight to the non-excluded CDS market. We believe that the operation of one or more CCPs in accordance with our exemptions likely would improve the efficiency and effectiveness of the CDS market, provide clearing participants with increased transparency of exposures to particular reference entities or reference securities, and increase available information about reference entities or reference securities.

Absent an exemption, the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP would have to be registered under the Securities Act, the eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP would have to be registered as a class under the Exchange Act, and the provisions of the Trust Indenture Act would apply. We believe that the interim final temporary rules exempting the registration of eligible CDS issued or cleared by a Registered or Exempt CCP under certain conditions will facilitate the use by eligible contract participants of CDS CCPs. Without also exempting the offers and sales of eligible CDS issued or cleared by a Registered or Exempt CCP from the registration requirements of the Securities Act and the Exchange Act and the provisions of the Trust Indenture Act, we believe that the CCPs would not be able to operate in the manner contemplated by the exemptive orders.

The interim final temporary exemptions also will treat eligible CDS issued or cleared by a Registered or Exempt CCP under the Securities Act and the Exchange Act in the same manner as certain other types of derivative contracts, such as security futures products and standardized options.[48] A Registered or Exempt CCP issuing or clearing eligible CDS will benefit from the temporary exemptions because it will not have to file registration statements with us covering the offer and sale of the eligible CDS. The registration form most applicable to a CCP is a Form S-20, which is the form that is used by options clearing houses that do not qualify for our exemption in Securities Act Rule 238[49] from registering the offer and sale of standardized options. If a CCP is not required to register the offer and sale of eligible CDS (on Form S-20, for example), it would not have to incur the costs of such registration, including legal and accounting costs. Some of these costs, of course, such as the costs of obtaining audited financial statements, may still be incurred as a result of the operations of the entity as a CCP and the regulatory oversight of the central counterparty operations. In addition, if any of the CCPs are entities that are subject to the periodic reporting requirements of the Exchange Act, the cost of

48 See, e.g., Securities Act Section 3(a)(14) [15 U.S.C. 77c(a)(14)], Securities Act Rule 238 [17 CFR 230.238]; Exchange Act Section 12(a) [15 U.S.C. 78l], and Exchange Act Rule 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)].

49 17 CFR 230.238.

filing a registration statement covering the eligible CDS would be lessened further as the information regarding the CCP already would be prepared. The availability of exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act also would mean that CCPs would not incur the costs of preparing disclosure documents describing eligible CDS and from preparing indentures and arranging for the services of a trustee.

B. Costs

The interim final temporary rules exempting offers and sales of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP should facilitate the use by eligible contract participants of CDS CCPs that are the subject of exemptive orders at minimal cost to the CCP or investors. Because the interim final temporary rules are self-executing, the costs of being able to rely on such exemptions, we believe, are minimal.

Absent an exemption, a CCP may have to file a registration statement covering the offer and sale of the eligible CDS, may have to satisfy the applicable provisions of the Trust Indenture Act, and may have to register the class of eligible CDS that it has issued or cleared under the Exchange Act, which would provide investors with civil remedies in addition to antifraud remedies. While a CCP registration statement covering eligible CDS (or the offer and sale of such eligible CDS) may provide certain information about the CCP, CDS contract terms, and the identification of reference entities or reference securities, it would not necessarily provide the type of information necessary to assess the credit risk of the reference entity or reference security. Further, while a CCP registration statement would provide information to the CDS market participants, as well as to the market as a whole, a condition of the clearing agency exemption in the exemptive orders is that the CCPs make their audited financial statements and other information about themselves publicly available. We recognize that a consequence of the exemptions would be the unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the Trust Indenture Act. While an investor would be able to pursue an antifraud action in connection with the purchase and sale of eligible CDS under Exchange Act Section 10(b),[50] it would not be able to pursue civil remedies under Sections 11 or 12 of the Securities Act.[51] We could still pursue an antifraud action in the offer and sale of eligible CDS issued or cleared by a CCP.[52]

VII. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act[53] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. 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. In addition, Section 2(b)[54] of the Securities Act and Section 3(f)[55] of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

We are adopting interim final temporary rules that would exempt eligible CDS issued or cleared by a Registered or Exempt CCP from all provisions of the Securities Act, other than the Section 17(a) antifraud provision, as well as from the registration requirements under Section 12

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[50] 15 U.S.C. 78j(b).

[51] 15 U.S.C. 77k and 77l.

[52] See 15 U.S.C. 77q and 15 U.S.C. 78j(b).

[53] 15 U.S.C. 78w(a)(2).

[54] 15 U.S.C. 77b(b).

[55] 15 U.S.C. 78c(f).

of the Exchange Act and the provisions of the Trust Indenture Act. Because our interim final temporary exemptions will be available to any Registered or Exempt CCP offering and selling eligible CDS, we do not believe that our actions today will impose a burden on competition. We also believe that the ability to settle CDS through CCPs will improve the transparency of the CDS market and provide greater assurance to participants as to the capacity of the eligible CDS counterparty to perform its obligations under the eligible CDS. We believe that increased transparency in the CDS market could help to decrease further market turmoil and thereby facilitate the capital formation process.

VIII. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission hereby certifies pursuant to 5 U.S.C. 605(b) that the interim final temporary rules contained in this release will not have a significant economic impact on a substantial number of small entities. The interim final temporary rules exempt eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP. None of the entities that are eligible to meet the requirements of the exemption from registration under Section 17A is a small entity. For this reason, the interim final temporary rules should not have a significant economic impact on a substantial number of small entities.

IX. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS

The rules and amendments described in this release are being adopted under the authority set forth in Sections 18, 19 and 28 of the Securities Act; Sections 12(h), 23(a) and 36 of the Exchange Act; and Section 304(d) of the Trust Indenture Act.

List of Subjects

17 CFR Parts 230, 240 and 260

Reporting and recordkeeping requirements, Securities.

TEXT OF THE RULES AND AMENDMENTS

For the reasons set out in the preamble, the Commission amends Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 230 - GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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2. Section 230.146 is amended by adding paragraph (c)T to read as follows:

§230.146 Rules under section 18 of the Act.

* * * * *

(c)T Temporary definition of eligible contract participant as qualified purchaser. For purposes of Section 18(b)(3) of the Act (15 U.S.C. 77r(b)(3)), the term "qualified purchaser" shall mean any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)) as in effect on the date of adoption of this section, other than a person who is an eligible contract participant under Section 1(a)(12)(C) of the Commodity Exchange Act) that has been sold an eligible credit default swap (as defined in Rule 239T of this Act) in reliance on Rule 239T of this Act. This temporary rule will expire on September 25, 2009.

3. Section 230.239T is added to read as follows:

§230.239T Temporary exemption for eligible credit default swaps.

(a) Except as expressly provided in paragraph (b) and (c) of this section, the Act does not apply to any eligible credit default swap that is:

(1) Issued or cleared by a clearing agency registered as a clearing agency under Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Securities Exchange Act of 1934 pursuant to a rule, regulation, or order of the Commission; and

(2) Offered and sold only to an eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)) as in effect on the date of adoption of this section, other than a person who is an eligible contract participant under Section 1(a)(12)(C) of the Commodity Exchange Act).

(b) The exemption provided in paragraph (a) of this section does not apply to the provisions of Section 17(a) of the Act (15 U.S.C. 77q(a)).

(c) <u>Offers and sales</u>. Any offer or sale of an eligible credit default swap pursuant to this section by or on behalf of the issuer of an identified security that is to be delivered if there is a credit-related event or whose value is used to determine the amount of the settlement obligation, an affiliate of such issuer, or an underwriter, will constitute a "contract for sale of," "sale of," "offer for sale," or "offer to sell" such identified security under Section 2(a)(3) of the Act (15 U.S.C. 77b(a)(3)).

(d) <u>Definition of Eligible Credit Default Swap</u>. For purposes of this section, an eligible credit default swap is a bilateral executory derivative contract not subject to individual negotiation:

(1) in which a buyer makes payments to the seller and, in return, receives a payout if there is a default or other credit event involving identified obligation(s) or identified entity(ies) within a certain time; and

(2) the agreement for which includes the:

(i) specification of the identified obligation or obligor; or, in the case of a identified group or index thereof, all of the identified obligations or obligors comprising any such group or index;

(ii) term of the agreement;

(iii) notional amount upon which payment obligations are calculated;

(iv) credit-related events that trigger a settlement obligation; and

(v) obligations to be delivered if there is a credit-related event or, if it is a cash settlement, the obligations whose value is to be used to determine the amount of settlement obligation under the eligible credit default swap.

(e) This temporary rule will expire on September 25, 2009.

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

4. 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.

* * * * *

5. Section 240.12a-10T is added to read as follows:

§240.12a-10T Temporary exemption of eligible credit default swaps from Section 12(a) of the Act.

(a) The provisions of Section 12(a) of the Act (15 U.S.C. 78l(a)) do not apply in respect of any eligible credit default swap, as defined in Rule 239T of the Securities Act of 1933 (17 CFR 230.239T) issued or cleared by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission, that will be purchased by or sold to an eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)) as in effect on the date of adoption of this section, other than a person who is an eligible contract participant under Section 1(a)(12)(C) of the Commodity Exchange Act).

(b) This temporary rule will expire on September 25, 2009.

6. Section 240.12h-1 is amended by adding paragraph (h)T to read as follows:

§240.12h-1 Exemptions from registration under section 12(g) of the Act.

* * * * *

(h)T any eligible credit default swap, as defined in Rule 239T of the Securities Act of 1933 (17 CFR 230.239T), issued or cleared by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission that will be purchased by or sold to an eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)) as in effect on the date of adoption of this section, other than a person who is an eligible contract participant under Section 1(a)(12)(C) of the Commodity Exchange Act). This temporary rule will expire on September 25, 2009.

PART 260 - GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939

7. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

8. Section 260.4d-11T is added to read as follows:

§260.4d-11T Temporary exemption for eligible credit default swaps offered and sold in reliance on Securities Act of 1933 Rule 239T (§230.239T).

Any eligible credit default swap (as defined in Rule 239T of this chapter, 17 CFR 230.239T), whether or not issued under an indenture, is exempt from the Act if offered and sold in reliance on Rule 239T of this chapter. This temporary rule will expire on September 25, 2009.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

January 14, 2009

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

[Release Nos. 33-9000, 34-59248, 39-2460, IC-28600, IA-2830; File No. S7-03-09]

List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act

AGENCY: Securities and Exchange Commission.

ACTION: Publication of list of rules scheduled for review.

SUMMARY: The Securities and Exchange Commission is today publishing a list of rules to be reviewed pursuant to Section 610 of the Regulatory Flexibility Act. The list is published to provide the public with notice that these rules are scheduled for review by the agency and to invite public comment on them.

DATES: Comments should be submitted by [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 to rule-comments@sec.gov. Please include File Number S7-03-09 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-03-09. 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 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 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: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA"), codified at 5 U.S.C. 600-611, requires an agency to review its rules that have a significant economic impact upon a substantial number of small entities within ten years of the publication of such rules as final rules. 5 U.S.C. 610(a). The purpose of the review is "to determine whether such rules should be continued without change, or should be amended or rescinded . . . to minimize any significant economic impact of the rules upon a substantial number of such small entities." 5 U.S.C. 610(a).

The RFA sets forth specific considerations that must be addressed in the review of each rule:

- the continued need for the rule;
- the nature of complaints or comments received concerning the rule from the public;
- the complexity of the rule;
- the extent to which the rule overlaps, duplicates or conflicts with other federal rules, and, to the extent feasible, with state and local governmental rules; and
- the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule. (5 U.S.C. 610(c))

The Securities and Exchange Commission, as a matter of policy, reviews all final rules that it published for notice and comment to assess not only their continued compliance with the RFA, but also to assess generally their continued utility.[1] The list below is therefore broader than that required by the RFA, and may include rules that do not have a substantial impact on a significant number of small entities. Where the Commission has previously made a determination of a rule's impact on small businesses, the determination is noted on the list. The Commission particularly solicits public comment on whether the rules listed below affect small businesses in new or different ways than when they were first adopted.

The rules and forms listed below are scheduled for review by staff of the Commission during the next twelve months. The list includes rules from 1998, 1997, 1996 and 1995.

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[1] When the Commission implemented the Act in 1980, it stated that it "intend[ed] to conduct a broader review [than that required by the RFA], with a view to identifying those rules in need of modification or even rescission." Securities Act Release No. 6302 (Mar. 20, 1981), 46 FR 19251 (Mar. 30, 1981).

The rules are grouped according to which Division or Office of the Commission recommended their adoption.

Division of Corporation Finance

Title:	Plain English Disclosure
Citation:	17 CFR 230.421, 17 CFR 230.481
Authority:	15 U.S.C. 77a et seq.
Description:	This rule requires that issuers write the cover page, summary and risk factors sections of prospectuses in plain English.
Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7497, which was approved by the Commission on January 28, 1998, which amended Rules 421 and 481. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title:	Regulation S
Citation:	17 CFR 230.900 -905

Authority: 15 U.S.C. 77a et seq.

Description: This rule provides a safe harbor from the term "offer" for certain offshore communications made by a registrant.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7470, which was approved by the Commission on October 10, 1997. Rule 902 was originally adopted as part of Regulation S in Release No. 33-6863, containing a Final Regulatory Flexibility Analysis which was approved by the Commission on April 24, 1990. Comments to the proposing releases and Initial Regulatory Flexibility Analyses were considered at those times.

* * * * *

Title: Rule 135e: Offshore press conferences, meetings with issuer representatives conducted offshore, and press-related material released offshore.

Citation: 17 CFR 230.135e

Authority: 15 U.S.C. 77a et seq.

Description: This rule provides a safe harbor from the term "offer" for certain offshore communications made by a registrant.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7470, which was approved by the Commission on October 10, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 12a-8: Exemption of depositary shares

Rule 15d-3: Reports for depositary shares registered on Form F-6.

Citation: 17 CFR 240.12a-8, 17 CFR 240.15d-3

Authority: 15 U.S.C. 78a et seq.

Description: These rules are designed to provide exemptions for depositary shares from section 12(a) of the Securities Act and from certain reporting requirements.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7431, which was approved by the Commission on July 18, 1997. Comments to the proposing release and Initial Flexibility Analysis were considered at that time.

* * * * *

<u>Title</u>:	Item 305 of Regulation S-K
<u>Citation</u>:	17 CFR 229.305
<u>Authority</u>:	15 U.S.C. 77a <u>et seq</u>.
<u>Description</u>:	This rule requires quantitative and qualitative disclosures about market risk.
<u>Prior Commission Determination Under 5 U.S.C. 601</u>:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7386, which was approved by the Commission on January 31, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

<u>Title</u>:	Delivery of Prospectus.
<u>Citation</u>:	17 CFR 240.15c2-8
<u>Authority</u>:	15 U.S.C. 78a <u>et seq</u>.
<u>Description</u>:	This rule establishes the requirements for brokers and dealers to deliver a prospectus to purchasers of securities.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7168, which was approved by the Commission on May 11, 1995. Comments to the proposing release and Initial Flexibility Analysis were considered at that time.

* * * * *

Title: Exemption for Certain California Limited Issues

Citation: 17 CFR 230.1001

Authority: 15 U.S.C. 77a et seq.

Description: The rule exempts from the registration requirements of the Securities Act offers and sales up to $5 million that are exempt from state qualification under paragraph (n) of Section 25102 of the California Corporations Code. The purpose of the rule is to assist small businesses' capital raising ability by creating a federal exemption for offering of up to $5 million that meet the qualifications of a California exemption.

Prior Commission Determination Under

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7285, which was approved by the Commission on May 1, 1996. Comments to the proposing release and Initial Flexibility Analysis were considered at that time.

* * * * *

Title: Settlement Cycle.

Citation: 17 CFR 240.15c6-1

Authority: 15 U.S.C. 77a et seq.

Description: This rule imposes a time requirement for brokers and dealers to complete the settlement of a securities transaction.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7168, which was approved by the Commission on May 11, 1995. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

Division of Investment Management

Title:	Rule 203A-1
Citation:	17 CFR 275.203A-1
Authority:	15 U.S.C. 80b-3a(a)(1)(A), 15 U.S.C. 80b-3a(c), 15 U.S.C. 80b-11(a)
Description:	The Commission adopted rule 203A-1 to implement the Investment Advisers Supervision Coordination Act, which, among other things, reallocated the responsibilities for regulating investment advisers between the Commission and the state securities regulatory authorities. The rule increases the threshold for state registered advisers to switch to Commission registration to $30 million in assets under management and requires that advisers to registered investment companies be registered with the Commission. The rule also provides state registered advisers with assets under management between $25 million and $30 million an option to remain registered with the states or to switch to Commission registration. In addition, the rule contains provisions prescribing procedures for switching registration from states to the Commission or vice versa.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IA-1633, which was approved by the Commission on May 15, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 203A-2

Citation: 17 CFR 275.203A-2

Authority: 15 U.S.C. 80b-3a(c)

Description: The Commission adopted rule 203A-2 to implement the Investment Advisers Supervision Coordination Act, which, among other things, reallocates the responsibilities for regulating investment advisers between the Commission and the state securities regulatory authorities. The rule exempts certain types of investment advisers from the prohibition on Commission registration. As a result, the following investment advisers are not prohibited from registering with the Commission: nationally recognized statistical rating organizations, pension consultants, investment advisers controlling, controlled by, or under common control with an investment adviser registered with the Commission, investment advisers expecting to be eligible for Commission registration within 120 days, multi-state investment advisers, and internet investment advisers.

<u>Prior Commission Determination Under 5 U.S.C. 601</u>:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IA-1633, which was approved by the Commission on May 15, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

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<u>Title</u>:	Rule 203A-3
<u>Citation</u>:	17 CFR 275.203A-3
<u>Authority</u>:	15 U.S.C. 80b-2a(17), 15 U.S.C. 80b-11(a)
<u>Description</u>:	The Commission adopted rule 203A-3 to implement the Investment Advisers Supervision Coordination Act, which, among other things, reallocates the responsibilities for regulating investment advisers between the Commission

and the state securities regulatory authorities. The rule defines certain terms for purposes of section 203A of the Investment Advisers Act (15 U.S.C. 80b-3a) and the rules thereunder. The terms defined in this rule include: "investment adviser representative," "excepted person," "impersonal investment advice," "place of business," and "principal office and place of business."

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IA-1633, which was approved by the Commission on May 15, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 203A-4

Citation: 17 CFR 275.203A-4

Authority: 15 U.S.C. 80b-11(a)

Description: The Commission adopted rule 203A-4 to implement the Investment Advisers Supervision Coordination Act, which, among other things, reallocates the responsibilities for regulating investment advisers between the Commission and the state securities regulatory authorities. The rule states that the Commission shall not assert a violation of section 203 of the Investment Advisers Act of 1940 (15 U.S.C 80b-3) by a state registered adviser for failure to register with the Commission if the adviser reasonably believes that it does not have assets under management of at least $30 million and is therefore not required to register with the Commission.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IA-1633, which was approved by the Commission on May 15, 1997. Comments to the proposing release and Initial Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 2a51-1

Citation: 17 CFR 270.2a51-1

Authority: 15 U.S.C. 80a-1 et seq., 80a-2(a)(51)(B), 80a-6(c), 80a-37(a)

Description: Rule 2a51-1 under the Investment Company Act of 1940 ("Act") defines the term "investment" for purposes of section 2(a)(51) of the Act, and section 3(c)(7) of the Act, which excludes from regulation under the Act privately offered companies that sell their securities to "qualified purchasers" owning or investing on a discretionary basis a specified amount of "investments."

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 2a51-2

Citation: 17 CFR 270.2a51-2

Authority: 15 U.S.C. 80a-1 et seq., 80a-2(a)(51)(B), 80a-6(c), 80a-37(a)

Description: Rule 2a51-2 under the Investment Company Act of 1940 ("Act") defines the term "beneficial owner" for purposes of section 2(a)(51) of the Act and section 3(c)(7)(B) of the Act, which permitted unregulated private companies that, on or before September 1, 1996, relied on section 3(c)(1) of the Act (which excludes from regulation under the Act privately offered companies with 100 or fewer "beneficial owners") to convert to unregulated private companies in reliance on section 3(c)(7) of the Act (which excludes from regulation under the Act privately offered companies that sell their securities to "qualified purchasers" owning or investing on a discretionary basis a specified amount of "investments"). Section 3(c)(7) of the Act was enacted in 1996.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 2a51-3

Citation: 17 CFR 270.2a51-3

Authority: 15 U.S.C. 80a-1 et seq., 80a-2(a)(51)(B), 80a-6(c), 80a-37(a)

Description: Rule 2a51-3 under the Investment Company Act of 1940 ("Act") provides that a company cannot be a "qualified purchaser" for purposes of section 3(c)(7) of the Act (which excludes from regulation under the Act privately offered companies that sell their securities to "qualified purchasers" owning or investing on a discretionary basis a specified amount of "investments" ("private fund")) if it was formed for the specific purpose of acquiring the securities offered by a private fund unless each beneficial owner of the company's securities is a qualified purchaser.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 3c-1

Citation: 17 CFR 270.3c-1

Authority: 15 U.S.C. 80a-1 et seq., 80a-6(c), 80a-37(a)

Description: Rule 3c-1 under the Investment Company Act of 1940 ("Act") defines the term "beneficial owner" for purposes of section 3(c)(1) of the Act, which excludes from regulation under the Act privately offered companies with 100 or fewer "beneficial owners."

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC- 22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 3c-5

Citation: 17 CFR 270.3c-5

Authority: 15 U.S.C. 80a-1 et seq., 80a-6(c), 80a-37(a)

Description: Rule 3c-5 under the Investment Company Act of 1940 ("Act") permits "knowledgeable employees" of a privately offered company (or knowledgeable employees of the company's affiliates) to invest in the company without causing the company to lose its exclusion from regulation under section 3(c)(1) or section 3(c)(7) of the Act. Section 3(c)(1) of the Act excludes from regulation under the Act privately offered companies with 100 or fewer "beneficial owners." Section 3(c)(7) of the Act excludes from regulation under the Act privately offered companies that sell their securities to "qualified purchasers" owning or investing on a discretionary basis a specified amount of "investments."

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC- 22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 3c-6

Citation: 17 CFR 270.3c-6

Authority: 15 U.S.C. 80a-1 et seq., 80a-3(c) (1), 80a-3(c) (7), 80a-6(c), 80a-37(a)

Description: Rule 3c-6 under the Investment Company Act of 1940 ("Act") treats persons who acquire securities of a privately offered company that is excluded from regulation under the Act in reliance on section 3(c)(7) of the Act as qualified purchasers for purposes of those securities if the acquisition is in accordance with the rule. Section 3(c)(7) of the Act excludes from regulation under the Act privately offered companies that sell their securities to "qualified purchasers" owning or investing on a discretionary basis a specified amount of "investments."

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22597, which was approved by the Commission on April 3, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 3a-4

Citation: 17 CFR 270.3a-4

Authority: 15 U.S.C. 80a-1 et seq., 80a-6(c), 80a-37(a)

Description: Rule 3a-4 under the Investment Company Act of 1940 ("Act") provides a nonexclusive safe harbor from the definition of investment company for certain investment advisory programs. Under the rule, an investment program organized and operated in accordance with the rule's provisions is deemed not to be an investment company within the meaning of the Act.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22579, which was approved by the Commission on March 24, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 17f-6

Citation: 17 CFR 270.17f-6

Authority: 15 U.S.C. 80a-1 et seq., 80a-6(c), 80a-37(a)

Description: Rule 17f-6 under the Investment Company Act of 1940 permits registered investment companies to maintain their assets with futures commission merchants and certain other entities in connection with futures contracts and commodity options traded on U.S. and foreign exchanges.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-22389, which was approved by the Commission on December 11, 1996. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 17a-9

Citation: 17 CFR 270.17a-9

Authority: 15 U.S.C. 80a-1 et seq., 80a-6(c), 80a-37(a)

Description: Rule 17a-9 under the Investment Company Act of 1940 (the "Act") specifies conditions under which, notwithstanding section 17(a) of the Act, a money market fund affiliate may purchase from the money market fund securities that are no longer "eligible securities" for purposes of rule 2a-7.

Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-21837, which was approved by the Commission on March 21, 1996. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title:	Form 24F-2
Citation:	17 CFR 274.24
Authority:	15 U.S.C. 60a-1 et seq.
Description:	Rule 24f-2 requires every open-end management investment company, face amount certificate company, or unit investment trust that is deemed to have registered an indefinite amount of securities pursuant to Section 24(f) of the Investment Company Act to file form 24F-2, Annual Notice of Securities Sold Pursuant to Rule 24f-2.

Prior Commission Determination Under

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7208, which the Commission approved on September 1, 1995. Comments to the proposing release and Initial Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 18f-3

Citation: 17 CFR 270.18f-3

Authority: 15 U.S.C. 80a-1 et seq., 80a-37, 80a-39

Description: Rule 18f-3 under the Investment Company Act of 1940 ("Act") specifies conditions under which, notwithstanding sections 18(f)(1) and 18(i) of the Act, a registered open-end management investment company or series or class thereof established in accordance with section 18(f)(2) of the Act whose shares are registered on Form N-1A may issue more than one class of voting stock.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-7143, which was approved by the Commission on February 23, 1995. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Rule 6c-10

Citation: 17 CFR 270.6c-10

Authority: 15 U.S.C. 80a-1 et seq., 80a-37, 80a-39

Description: Rule 6c-10 under the Investment Company Act of 1940 ("Act") specifies conditions under which, notwithstanding sections 2(a)(32), 2(a)(35), and 22(d) of the Act, a registered open-end management investment company or series or class thereof may permit a contingent deferred sales load to be imposed on shares issued by the company.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. IC-20916, which was approved by the Commission on February 23, 1995. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

Division of Trading and Markets

Title: Regulation of Exchanges and Alternative Trading Systems

Citation: 17 CFR Parts 202, 240, 242 and 249

Authority: 15 U.S.C. 78 et seq., particularly Sections 78c(b), 78e, 78f, 78k-1, 78o, 78q(a), 78q(b), 78s, 78w(a), and 78mm.

Description: The Commission adopted new rules and rule amendments to allow alternative trading systems to choose whether to register as national securities exchanges, or to register as broker-dealers and comply with additional requirements under Regulation ATS, depending on their activities and trading volume. The Commission also adopted amendments to rules regarding registration as a national securities exchange, repealing rule 17a-23, and amending the books and records rules by transferring the recordkeeping requirements from rule 17a-23 to rules 17a-3 and 17a-4 as they apply to broker-dealer internal trading systems. Finally, the Commission excluded from the rule filing requirements for self-regulatory organizations certain pilot trading systems operated by national securities exchanges and national securities associations. These rules integrated the growing number of alternative trading systems into the national market system, accommodated the registration of proprietary alternative trading systems as exchanges, and provided an opportunity for registered exchanges to better compete with alternative trading systems.

Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-40760, which was approved by the Commission on December 11, 1998. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title:	Amendment to Rule Filing Requirements For Self-Regulatory Organizations Regarding New Derivative Securities Products
Citation:	17 CFR 240.19b-4(e)
Authority:	15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll(d), 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11.

Description: The Commission amended rule 19b-4 under the Securities Exchange Act of 1934 to permit self-regulatory organizations to list and trade new derivative securities products pursuant to existing self-regulatory organization trading rules, procedures, surveillance programs and listing standards without submitting a proposed rule change pursuant to Section 19(b).

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-40761, which was approved by the Commission on December 8, 1998. The Commission received no comments on the Initial Regulatory Flexibility Analysis.

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Title: OTC Derivatives Dealers

Citation: 17 CFR 200.30-3, 240.3b-12, 240.3b-13, 240.3b-14, 240.3b-15, 240.8c-1, 240.11a1-6, 240.15a-1, 240.15b1-1, 240.15c2-1, 240.15b9-2, 240.15c2-5, 240.15c3-1, 240.15c3-2, 240.15c3-3, 240.15c3-4, 240.17a-3, 240.17a-4, 240.17a-5, 240.17a-11, 240.17a-12, 240.36a1-1, 240.36a1-2, and 249.617.

<u>Authority</u>:	15 U.S.C. 78a <u>et seq.</u>) (3(b), 11(a), 15(a), 15(b), 15(c), 17(a), 23, and 36) (15 U.S.C. 78c(b), 78k(a), 78o(a), 78o(b), 78o(c), 78q(a), 78w, and 78mm)).
<u>Description</u>:	The Commission adopted new rules and rule amendments to tailor capital, margin, and other broker-dealer regulatory requirements to a class of registered dealers, called OTC derivatives dealers, that are active in over-the-counter derivatives markets. Registration as an OTC derivatives dealer under these rules is optional and is an alternative to registration as a broker-dealer under the traditional broker-dealer regulatory structure. It is available only to entities that engage in dealer activities in eligible over-the-counter derivative instruments and that meet certain financial responsibility and other requirements.
<u>Prior Commission Determination Under 5 U.S.C. 601</u>:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-40594, which was approved by the Commission on October 23, 1998. The Commission

received no comments on the Initial Regulatory Flexibility Analysis.

* * * * *

Title: Lost Securityholders

Citation: 17 CFR 240.17Ad–17, 240.17Ad–7, and 249b.102

Authority: 15 U.S.C. 77a et seq., 15 U.S.C. 78a *et seq.*, 15 U.S.C. 79a et seq., 15 U.S.C. 80a et seq.

Description: The Commission adopted rules 17Ad–17 and 17a–24[2] under the Securities Exchange Act of 1934, and amended form TA–2 and rule 17Ad–7 under the Securities Exchange Act. Rule 17Ad–17 (designed to reduce the number of "lost securityholders") requires transfer agents to conduct searches in an effort to locate lost securityholders. The amendment to rule 17Ad-7 set forth the retention time period for the records relating to compliance with rule 17Ad-17, and the amendments to form TA-2 provide the means for transfer agents to report required information to the Commission.

Prior Commission Determination Under

[2] The Commission rescinded rule 17a-24 in a revised transfer agent rule, Release No. 34-42892 (July 9, 2000).

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34–39176, which was approved by the Commission on October 1, 1997. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Net Capital Rule

Citation: 17 CFR 240.15c3-1

Authority: 15 U.S.C. 77a et seq., 15 U.S.C. 78a et seq., 15 U.S.C. 79a et seq., 15 U.S.C. 80a et seq.

Description: The Commission amended rule 15c3-1 ("Net Capital Rule") under the Securities Exchange Act of 1934 to permit broker-dealers to employ theoretical option pricing models in determining net capital requirements for listed options and related positions. Alternatively, the rule permits broker-dealers to elect a strategy-based methodology. The amendments simplified the Net Capital Rule's treatment of options for capital purposes and were designed to more accurately reflect the risk inherent in broker-dealer options positions.

Prior Commission Determination Under

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-38248, which was approved by the Commission on February 6, 1997. The Commission received no comments on the Initial Regulatory Flexibility Analysis.

* * * * *

Title: Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934

Citation: 17 CFR 240.17a-4

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11.

Description: The Commission amended the broker-dealer record preservation rule to allow broker-dealers to employ, under certain conditions, electronic storage media to maintain records required to be retained. The Commission also issued an interpretation of its record preservation rule relating to the treatment of electronically generated communications.

Prior Commission Determination Under

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-38245, which was approved by the Commission on January 31, 1997. The Commission received no comments on the Initial Regulatory Flexibility Analysis.

* * * * *

Title : Anti-Manipulation Rules Concerning Securities Offerings

Citation: 17 CFR 228.502, 228.508, 229.502, 229.508, 230.418, 230.461, 240.10b-18, 240.11a-1, 240.13e-4, 240.13e-102, 240.14d-102, 240.17a-2, and 17 CFR Part 242

Authority: 15 U.S.C. 77a et seq., 15 U.S.C. 78a et seq., 15 U.S.C. 79a et seq., 15 U.S.C. 80a et seq.

Description: The Commission adopted new Regulation M governing the activities of underwriters, issuers, selling security holders, and others in connection with offerings of securities. Regulation M was intended to preclude manipulative conduct by persons with an interest in the outcome of an offering. Regulation M significantly eased regulatory burdens on offering participants by eliminating the trading restrictions for underwriters of actively-traded securities; reducing the scope of coverage for other securities;

reducing restrictions on issuer plans; providing a more flexible framework for stabilizing transactions; and deregulating rights offerings. Consisting of five new rules, plus a new definitional rule, Regulation M replaced rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21 ("trading practices rules") under the Securities Exchange Act of 1934 ("Exchange Act"), which were rescinded. In addition, related amendments were made to Items 502(d) and 508 of Regulations S-B and S-K, and to rules 10b-18 and 17a-2 under the Exchange Act. Conforming changes to various rules under the Securities Act of 1933 and the Exchange Act were made to reflect the repeal of the trading practices rules and the adoption of Regulation M.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-38067, which the Commission approved on December 20, 1996. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Odd-Lot Tender Offers by Issuer

Citation: 17 CFR 240.13e-4,

Authority: 15 U.S.C. 77a et seq., 15 U.S.C. 78a et seq., 15 U.S.C. 79a et seq., 15 U.S.C. 80a et seq.

Description: The Commission adopted an amendment to rule 13e-4 under the Securities Exchange Act of 1934 ("Exchange Act"). The amendment removed the rule's requirement that an issuer cash tender offer made to odd-lot holders specify a record date of ownership for eligibility to tender into the offer. The amendment enabled issuers to conduct continuous, periodic, or extended odd-lot offers for their equity securities. The Commission also granted a class exemption from rule 10b-13,[3] and a temporary class exemption from rule 10b-6,[4] under the Exchange Act to permit issuers to conduct odd-lot offers, to "round-up" odd-lots on behalf of odd-lot holders, and to make purchases of their securities otherwise than pursuant to the odd-lot offer.

Prior Commission Determination Under 5 U.S.C. 601: The Chairman of the Commission certified in connection with the Proposing Release that the proposed amendment to

[3] The Commission replaced rule 10b-13 with new rule 14e-5 in adopting regulations on cross-border tender offers, Release No. 33-7760, 64 FR 61408 (Nov. 14, 1999).

[4] The Commission withdrew and replaced rule 10b-6 in adopting Regulation M, infra.

Rule 13e-4 and the proposed class exemptions from Rules 10b-6 and 10b-13, if adopted, would not have a significant impact on a substantial number of small entities. The Commission received no comments on this certification.

* * * * *

Title :	Order Execution Obligations (Rules 11Ac1-4 and 11Ac1-1)[5]
Citation:	17 CFR 240.11Aa3-1, 240.11Ac1-1 and 240.11Ac1-4 (renamed 17 CFR 242.601(a), 242.602(a)(1) and 242.604)
Authority:	15 U.S.C. 77a et seq., 15 U.S.C. 78a et seq., 15 U.S.C. 79a et seq., 15 U.S.C. 80a et seq.
Description:	The Commission adopted new rule 11Ac1-4 ("Display Rule") under the Securities Exchange Act of 1934 ("Exchange Act") to require the display of customer limit orders priced better than a specialist's or over-the-counter market maker's quote or that add to the size associated with such quote. The Commission also adopted amendments to rule 11Ac1-1 ("Quote Rule") under the Exchange Act to require a market maker to publish quotations for any listed security when it is responsible for more than 1% of the aggregate trading volume for that security and to make

[5] The Commission renumbered rules 11Ac1-1 and 11Ac1-4 in adopting Regulation NMS, Release No. 34-51808, 70 FR 37496 (June 29, 2005). They are now at 17 CFR 242.602 and 242.604, respectively.

publicly available any superior prices that a market maker privately quotes through certain electronic communications networks. These rules were designed to address growing concerns about the handling of customer orders for securities. Finally, the Commission deferred action on proposed rule 11Ac1-5. The substance of this regulation remains largely intact in rules 602 and 604 of Regulation NMS. See Release No. 34-51808, 69 FR 37496 (June 29, 2005).

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-37619A, which was approved by the Commission on September 6, 1996. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

* * * * *

Title: Unlisted Trading Privileges

Citation: 17 CFR 240.12f-1, 17 CFR 240.12f-2, 17 CFR 240.12f-3, 17 CFR 240.12f-5, 17 CFR 240.12f-6.

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78a, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o,

	78p, 78q, 78s, 78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11.
Description:	The Commission adopted new rules and rule amendments to reduce the period that exchanges must wait before extending Unlisted Trading Privileges ("UTP") to any listed initial public offering, from the third trading day in the security to the second trading day in the security. The rules also require exchanges to have rules and oversight mechanisms in place to ensure fair and orderly markets and the protection of investors with respect to UTP in any security.
Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-35637, which was approved by the Commission on April 21, 1995. Comments to the proposing release and Initial Regulatory Flexibility Analysis were considered at that time.

Office of General Counsel

Title :	Rules of Practice

Citation: 17 CFR Parts 200 and 201

Authority: 5 U.S.C. 551, 554, 556, and 557.

Description: The Commission comprehensively revisited its Rules of Practice ("Rules"), the procedural rules that govern Commission administrative proceedings. The proceedings include enforcement proceedings initiated by the Commission and review of disciplinary proceedings brought by self-regulatory organizations. They also cover administrative temporary cease-and-desist and disgorgement orders. The Rules implemented revised procedures for the conduct of hearings, including simplified service of orders instituting proceeding, expanded use of prehearing conferences, codification of policies on the availability of certain investigation files to respondents in enforcement and disciplinary proceedings, issuance of subpoenas returnable prior to hearing and the consideration by administrative law judges of dispositive motions prior to hearing.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34- 35833, which was approved the Commission on June 9, 1995. The Commission received no comments on the Initial Regulatory Flexibility Analysis.

Office of the Chief Accountant

Title:	Amendments to Rule 102(e): Appearance and practice before the Commission
Citation:	17 CFR 201.102
Authority:	15 U.S.C. 78a et seq.
Description:	These amendments to the Commission's Rules of Practice clarify the Commission's standard for determining when accountants engage in "improper professional conduct" such that the Commission can censure, suspend or bar accountants who appear and practice before it.
Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-40567, which was approved by the Commission on October 19, 1998. Comments to the proposing release and Initial Regulatory Flexibility analysis were considered at that time.

* * * * *

Title:	Rule 10A-1: Notice to the Commission pursuant to Section 10A of the Exchange Act
Citation:	17 CFR 240.10A-1
Authority:	15 U.S.C. 78a et seq.
Description:	These rules are designed to implement the reporting requirements in Section 10A of the Securities Exchange Act of 1934.
Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-38387, which was approved by the Commission on March 12, 1997. Comments to the proposing release and Initial Regulatory Flexibility analysis were considered at that time.

The Commission invites public comment on both the list and on the rules to be reviewed.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: January 14, 2009

Commissioner Aguilar not participating, Commissioner Paredes Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59249 / January 14, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2831 / January 14, 2009

INVESTMENT COMPANY ACT OF 1940
Release No. 28601 / January 14, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13063

In the Matter of

MICHAEL K. BRUGMAN,

Respondent.

CORRECTED ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

On June 11, 2008, the Securities and Exchange Commission ("Commission") instituted a public administrative proceeding pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Michael K. Brugman.

II.

In 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 Making Findings and Imposing Remedial Sanctions and A Cease-And-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 ("Order"), as set forth below:

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

From mid-2001 through December 2002, Brugman, who was at the time a wholesaler for Invesco Funds Group, Inc. ("IFG"), accepted personal payments totaling over $3 million from various entities in exchange for procuring market timing capacity with the Invesco funds. Brugman never disclosed these payments to IFG.

Respondent

1. Brugman, age 40, is a resident of Mount Kisco, New York. From approximately June 2000 through December 2002, Brugman was employed by IFG as a wholesaler for the Invesco Funds. He was also a registered representative associated with Invesco's affiliated broker-dealer, Invesco Distributors, Inc. Brugman assisted in the sale of shares of Invesco funds to institutional clients.

Other Relevant Entities

2. IFG, formerly a Delaware corporation headquartered in Denver, Colorado, was registered with the Commission as an investment adviser from 1957 until October 2004, when IFG withdrew its registration. IFG no longer conducts business. During the relevant time period, IFG served as an investment adviser to over forty-five mutual funds, each included within one of a series of eight registered open-end investment companies (the "Invesco funds").

Background

3. While employed with IFG, Brugman assisted in the sale of the Invesco funds to institutional clients. From the middle of 2001 until his resignation from IFG in December 2002, Brugman introduced at least four market timers to IFG in exchange for personal payments made

[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

to Brugman by the market timers. Brugman received some of these personal payments indirectly through entities established by a family member.

4. Brugman began accepting personal payments in approximately July 2001, when he successfully introduced a market timer to IFG that would potentially invest a substantial amount in the Invesco Funds.

5. At the beginning of this market timing relationship, this market timer executed its trades in the Invesco funds through a registered broker-dealer that was not affiliated with IFG. The market timer paid that broker-dealer a management fee equal to approximately 120 basis points for the market timing assets placed in the Invesco funds. The broker-dealer split these fees with Brugman, paying Brugman the equivalent of 30 of the 120 basis points fee it received. In an attempt to conceal this arrangement from Brugman's employer, Brugman's fee was first transferred to another entity, which in turn paid the fees to an entity associated with Brugman.

6. At the beginning of 2002, this market timer began placing its trades directly with the Invesco funds, rather than using the other broker-dealer, and continued to pay Brugman for its market timing arrangement with IFG. For 2002 alone, this market timer transferred over $3 million to Brugman.

7. Brugman also received personal payments from at least three other market timers that utilized the same broker-dealer as the market timer described above. Brugman received these payments by splitting with the broker-dealer the fees the market timers paid to the broker-dealer. Brugman received over $50,000 in such personal payments in 2002.

8. Brugman resigned from IFG, his last day was December 13, 2002.

9. As an employee of IFG, Brugman was IFG's agent and fiduciary. Therefore, Brugman had a duty to disclose to IFG that he intended to and did receive personal payments in connection with the market timing transactions. Brugman was further obligated to disclose to IFG his receipt of personal payments based on his written agreement, entered into during his employment with IFG, to abide by certain policies enforced by IFG, including policies prohibiting him from accepting compensation from outside sources or engaging in outside business activities without prior approval from IFG. However, Brugman never sought IFG's permission to accept the personal payments nor did he ever disclose to IFG his receipt of these payments.

10. By accepting the personal payments and knowingly participating in the scheme to conceal them from IFG, Brugman acted with scienter. Brugman's actions in personally profiting by over $3 million dollars from market timers, and concealing this fact from IFG and the funds, were material.

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

IV.

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

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

A. Respondent Brugman shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Brugman be, and hereby is barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

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

D. IT IS FURTHER ORDERED that Respondent shall, pay disgorgement of $700,000.00 as follows: immediately upon entry of this Order, Respondent shall pay disgorgement of $400,000.00, and within twelve months of the entry of this Order, Respondent shall pay the remaining disgorgement of $300,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue on any unpaid balance 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 Michael K. Brugman 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 Elizabeth E. Krupa, Denver Regional Office, 1801 California St, Suite 1500, Denver, CO 80202.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59257 / January 15, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13342

In the Matter of **Kings Road Entertainment, Inc.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Kings Road Entertainment, Inc. ("Kings Road" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which Respondent admits, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Kings Road (CIK No. 773588) is a Delaware corporation located in Beverly Hills, California. At all times relevant to this proceeding, the securities

of Kings Road have been registered with the Commission under Exchange Act Section 12(g). The securities of Kings Road are quoted on the Pink Sheets (symbol "KREN").

2. Kings Road has violated Exchange Act Section 13(a), and Rules 13a-1 and 13a-13 thereunder, because it has not filed any periodic reports in a timely fashion from the time it filed a Form 10-KSB for the period ended April 30, 2005, until it filed a timely Form 10-QSB for the period ended July 31, 2008.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Kings Road's Offer.

Accordingly, it is hereby ORDERED that:

Kings Road cease and desist from committing or causing any violations and any future violations of Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59256 / January 15, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13075

In the Matter of **K-2 Logistics.Com, Inc., *et al.*,** **Respondents.**	**ORDER DISMISSING PROCEEDINGS WITH PREJUDICE AS TO KINGS ROAD ENTERTAINMENT, INC.**

For good cause shown,

IT IS HEREBY ORDERED THAT this proceeding is hereby DISMISSED as to Respondent Kings Road Entertainment, Inc. with prejudice.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

20 of 36

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 28605 / January 16, 2009

In the Matter of

CITIGROUP GLOBAL MARKETS INC.
787 Seventh Avenue, 32nd Floor
New York, NY 10019

CEFOF GP I CORP.
388 Greenwich Street
New York, NY 10013

CELFOF GP CORP.
388 Greenwich Street
New York, NY 10013

CITIBANK, N.A.
399 Park Avenue
New York, NY 10043

CITIGROUP ALTERNATIVE INVESTMENTS LLC
731 Lexington Avenue, 28th Floor
New York, NY 10022

CITIGROUP INVESTMENT ADVISORY SERVICES INC.
787 7th Avenue, 15th Floor
New York, NY 10019

CITIGROUP CAPITAL PARTNERS I GP I CORP.
CITIGROUP CAPITAL PARTNERS I GP II CORP.
388 Greenwich Street
New York, NY 10013

(812-13615)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Citigroup Global Markets Inc. ("CGMI"), CEFOF GP I Corp., CELFOF GP Corp., Citibank, N.A., Citigroup Alternative Investments LLC, Citigroup Investment Advisory Services Inc., Citigroup Capital Partners I GP I Corp. and Citigroup Capital Partners I GP II Corp. (collectively, "Applicants") filed an application on December 23, 2008 requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which CGMI is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the Southern District of New York on December 23, 2008.

On December 23, 2008, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 28572) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the prohibitions of section 9(a) as applied to the Applicants would be unduly and disproportionately severe and the conduct of the Applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by Citigroup Global Markets Inc. et al. (File No. 812-13615), that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the United States District Court for the Southern District of New York on December 23, 2008.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 28606 / January 16, 2009

In the Matter of

UBS SECURITIES LLC
299 Park Avenue
New York, NY 10171

UBS FINANCIAL SERVICES INC.
1200 Harbor Boulevard
Weehawken, NJ 07086

UBS FUND ADVISOR, L.L.C.
UBS WILLOW MANAGEMENT, L.L.C.
UBS EUCALYPTUS MANAGEMENT, L.L.C.
UBS TAMARACK MANAGEMENT, L.L.C.
UBS JUNIPER MANAGEMENT, L.L.C.
UBS ENSO MANAGEMENT, L.L.C.
51 West 52nd Street
23rd Floor
New York, NY 10019

UBS GLOBAL ASSET MANAGEMENT (AMERICAS) INC.
One North Wacker Drive
Chicago, IL 60606

UBS GLOBAL ASSET MANAGEMENT (US) INC.
51 West 52nd Street
16th Floor
New York, NY 10019

UBS AG
UBS IB CO-INVESTMENT 2001 GP LIMITED
c/o UBS
677 Washington Boulevard
Stamford, CT 06901

(812-13609)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

UBS Securities LLC, UBS Financial Services Inc. (together with UBS Securities LLC, the "Settling Firms"), UBS Fund Advisor, L.L.C., UBS Willow Management, L.L.C., UBS Eucalyptus Management, L.L.C., UBS Tamarack Management, L.L.C., UBS Juniper Management, L.L.C., UBS Enso Management L.L.C., UBS Global Asset Management (Americas) Inc., UBS Global Asset Management (US) Inc., UBS AG and UBS IB Co-Investment 2001 GP Limited (collectively, "Applicants") filed an application on December 16, 2008, and an amendment to the application on January 12, 2009, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which either of the Settling Firms is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the Southern District of New York on December 23, 2008.

On December 23, 2008, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 28569) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the prohibitions of section 9(a) as applied to the Applicants would be unduly and disproportionately severe and the conduct of the Applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by UBS Securities LLC et al. (File No. 812-13609), as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the United States District Court for the Southern District of New York on December 23, 2008.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59268 / January 21, 2009

Admin. Proc. File No. 3-12684

In the Matter of

NATURE'S SUNSHINE PRODUCTS, INC.

c/o William H. Kimball
E. Andrew Southerling
W. Brad Nes
David A. Sirignano
Morgan, Lewis & Bockius LLP
1111 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

OPINION OF THE COMMISSION

SECTION 12(j) PROCEEDING

Grounds for Remedial Action

Failure to comply with periodic filing requirements

Issuer failed to file required periodic reports with the Commission in violation of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13. Held, it is necessary and appropriate for the protection of investors to revoke the registration of the issuer's common stock.

APPEARANCES:

William H. Kimball, E. Andrew Southerling, W. Brad Nes, and David A. Sirignano, of Morgan, Lewis & Bockius LLP, for Nature's Sunshine Products, Inc.

Karen L. Martinez and William McKean, for the Division of Enforcement.

Paul A. Belvin, for the Division of Corporation Finance.

Appeal filed: November 30, 2007
Last brief filed: December 5, 2008
Oral Argument held: January 7, 2009

I.

Nature's Sunshine Products, Inc. ("Nature's Sunshine" or the "Company") appeals from an administrative law judge's decision revoking the registration of its common stock pursuant to Section 12(j) of the Securities Exchange Act of 1934. 1/ On November 8, 2007, the law judge found that the Company had violated Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 13a-13 2/ by failing to file any annual report on Form 10-K since filing its Form 10-K for the year ended December 31, 2004, and by failing to file any quarterly report on Form 10-Q with financial statements that had been reviewed by its independent auditors since filing its Form 10-Q for the quarter ended June 30, 2005. 3/ We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. 4/

II.

Nature's Sunshine is a Utah corporation that manufactures and markets nutritional and personal care products. It has more than 1,100 employees and 730,000 distributors worldwide, with operations in the United States and other countries. Nature's Sunshine first registered its

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1/ 15 U.S.C. § 78*l*(j) (authorizing the Commission to suspend or revoke issuer's securities registration, after notice and an opportunity for a hearing, for failure to comply with the Exchange Act or its rules and regulations).

2/ 15 U.S.C. § 78m(a) (requiring issuers of securities registered under Exchange Act Section 12 to file periodic and other reports); 17 C.F.R. §§ 240.13a-1 (annual reports), 240.13a-13 (quarterly reports).

3/ Form 10-K requires that financial statements in annual reports must be audited. While financial statements in quarterly reports need not be audited, those statements must be reviewed by independent accountants before filing. See 17 C.F.R. §§ 210.10-01(d), 228.310(b). A Form 10-Q filed by Nature's Sunshine on November 22, 2005, for the quarter ended September 30, 2005, contained financial statements that had not been reviewed by its independent accountants. The November 22 Form 10-Q was the last periodic report filed by Nature's Sunshine prior to the institution of this proceeding on July 12, 2007.

4/ Commission Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of a proceeding if that member has reviewed the oral argument transcript prior to such participation. Commissioner Walter conducted the required review.

common stock with the Commission in 1978. The financial statements included in its Form 10-K for the year ended December 31, 2004, indicated net sales revenue of about $331 million and net income of about $17 million. The 2004 Form 10-K also indicated that the Company had approximately 1,266 shareholders of record and 15.5 million shares of common stock outstanding.

In the fall of 2005, Nature's Sunshine commenced an internal investigation of certain accounting and other issues related to its international operations. The internal investigation was conducted by independent counsel retained by a special committee appointed by Nature's Sunshine's audit committee. Nature's Sunshine disclosed this event in a Form 8-K filed in November 2005.

On or about March 15, 2006, Nature's Sunshine received a preliminary report regarding the internal investigation. The report stated that the Company had "internal control weaknesses" and had engaged in "potential violations of law." The report recommended that certain remedial measures be taken. On or about March 20, 2006, Nature's Sunshine filed a Form 8-K indicating that, based on issues raised in the preliminary report, the financial statements from 2002 onward could not be relied on, and that the Company could not predict whether, or to what extent, those prior year financial statements needed to be restated. The Form 8-K further indicated that management's report on internal controls over financial reporting, which was included in the 2004 Form 10-K, should not be relied upon.

On March 31, 2006, Nature's Sunshine's independent registered public accounting firm, KPMG LLP ("KPMG"), resigned. KPMG's resignation letter stated that Nature's Sunshine had been informed of "likely illegal acts" uncovered in the internal investigation; that those illegal acts appeared to have had a material effect on the Company's financial statements; and that the Company had not taken timely and appropriate remedial action. KPMG referred specifically to Nature's Sunshine's failure to terminate its chief executive officer, Douglas Faggioli, despite evidence indicating that he had "made misrepresentations to KPMG on at least two occasions" and had "approved a payment in violation of the Foreign Corrupt Practice[s] Act." 5/ KPMG also referred to Nature's Sunshine's failure to remove the former chair of its audit committee, Franz Cristiani, from the audit committee and board of directors, "even though he was found to have known of the misrepresentations, understood that they could be considered material from an auditing standpoint and could pose a significant problem to [the] Company, and failed to

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5/ The Foreign Corrupt Practices Act prohibits "any issuer which has a class of securities registered pursuant to [the Act] . . . or for any officer, director, employee, or agent of such issuer or any stockholder thereof . . . to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to any foreign official for purposes of influencing any act or decision of such foreign official in his official capacity." 15 U.S.C. § 78dd-1(a).

bring the matter to the attention of the auditors or correct the misrepresentations." At the time of its resignation, KPMG had not completed its audit of the Company's financial statements for the year ended December 31, 2005.

In April 2006, Nature's Sunshine began discussions with several independent registered public accounting firms about a possible audit engagement. However, those firms requested that the Company defer such discussions until after the internal investigation was completed. Nature's Sunshine acceded to those requests.

On or about April 3, 2006, Nature's Sunshine filed a Form 8-K that reported KPMG's resignation and attached a copy of the resignation letter. The Form 8-K indicated that KPMG had discussed with the Company that, because of the issues outlined and conclusions reached in the preliminary report of the investigative team, KPMG could no longer rely on management's representations. The Form 8-K also indicated that, pursuant to discussions with KPMG, Faggioli had "stepped down" as chief executive officer, president, and director of the Company pending the conclusion of the internal investigation, although he retained a "limited, non-executive role" at Nature's Sunshine, 6/ and Cristiani had been replaced as audit committee chairman. The Form 8-K stated that those personnel actions were "consistent" with the recommendations in the preliminary report. 7/

On April 5, 2006, Nasdaq removed Nature's Sunshine's common stock from quotation on The Nasdaq Stock Market for failure to file its required periodic reports with the Commission. Since then, Nature's Sunshine's common stock has been quoted in the Pink

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6/ We take official notice, pursuant to Rule of Practice 323, 17 C.F.R. § 201.323 (providing that Commission may take official notice of any matter in its public official records), of Nature's Sunshine's periodic filings, which indicate that Mr. Faggioli remains as the President and Chief Executive Officer of the Company.

7/ Nature's Sunshine argues that the Division of Enforcement (the "Division") improperly raises "unproven," "prejudicial," and "irrelevant" allegations of accounting irregularities, fraud, or other misconduct by certain senior officers and employees of the Company. Pursuant to Rule of Practice 323, we take official notice that the company filed several Forms 8-K disclosing KPMG's stated reasons for its resignation and the Company's responses thereto. Those Forms 8-K are in the Commission's official files. We are mindful that none of the allegations raised by the Division have been charged in the instant Order Instituting Proceedings ("OIP"). Further, we have not considered any of those allegations for their truth or in our disposition of this Exchange Act Section 12(j) proceeding.

Sheets. Its average trading volume has been several thousand shares per day, and its price has fluctuated between $5.25 and $11.00 per share. 8/

In late August 2006, after substantial completion of the internal investigation, Nature's Sunshine resumed discussions with potential auditors. On February 2, 2007, Nature's Sunshine formally engaged Deloitte & Touche LLP ("Deloitte") as its independent auditor, thereby ending a period of approximately ten months during which the Company was without any auditors. Between February 2007 and November 2007, Deloitte performed approximately 23,900 hours of audit work on Nature's Sunshine's financial statements for the years ended December 31, 2004, 2005, and 2006.

On July 12, 2007, the Commission issued an OIP against Nature's Sunshine for failure to file required periodic reports. 9/ In its answer, Nature's Sunshine admitted the allegations in the OIP, but stated that it was "diligently continuing its good faith efforts to return to compliance." According to the Company, those remedial efforts included adding new staff and increasing the work hours of its current staff to support the audit; hiring independent compliance consultants to improve internal controls over financial reporting; and continuously providing the public with selected, preliminary, unaudited, and unreviewed financial information in Forms 8-K and press releases.

On August 23, 2007, at a pre-hearing conference, Nature's Sunshine, through counsel, reiterated that it "hope[d]" to return to compliance by October 15, 2007. However, a Form 12b-25, 10/ filed five months earlier in connection with Nature's Sunshine's inability timely to file its 2006 Form 10-K, indicated that the Company could not predict a date by which it would become compliant.

At a subsequent conference on September 27, 2007, Nature's Sunshine, through counsel, stated that, although the October 15 date was "still a goal," it would be "very, very difficult" for

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8/ See http://www.pinksheets.com (last viewed Jan. 7, 2009).

9/ In a press release issued on the same day, Nature's Sunshine disclosed that its failure to comply with the Exchange Act's reporting requirements and the facts surrounding its internal investigation had led to various inquiries, document requests, and proceedings by government agencies, including the Commission, Department of Justice, and Internal Revenue Service.

10/ Under Exchange Act Rule 12b-25, issuers are required to notify the Commission of their inability to file a periodic report, along with supporting reasons, by filing a Form 12b-25 "no later than one business day after the due date" for such report. 17 C.F.R. § 240.12b-25(a); see 17 C.F.R. § 249.322 (Form 12b-25). Timely filing a Form 12b-25 provides an automatic extension of fifteen calendar days for filing a Form 10-K and five calendar days for filing a Form 10-Q. 17 C.F.R. § 240.12b- 25(b).

the Company to return to compliance by that date, and that it was "more realistic" for Nature's Sunshine "to be pushing to get the audit done by the end of October [2007]." However, Nature's Sunshine could not give a "firm estimate" for completion of the audit because Deloitte was "not willing to put a line in the sand and say . . . it will be done by this date or not by that date."

Nature's Sunshine did not return to compliance by October 15, 2007, and Deloitte's audit was not completed by the end of that month. On November 8, 2007, when the law judge issued her initial decision revoking the registration of the Company's common stock, Nature's Sunshine had not filed any of its delinquent periodic reports.

During the pendency of this appeal, on March 6, 2008, Nature's Sunshine filed a motion seeking leave to adduce additional evidence. 11/ The additional evidence consisted of a sworn, supplemental declaration dated March 5, 2008, from its chief financial officer, Stephen M. Bunker, regarding the status of Deloitte's audit. The supplemental declaration stated, in pertinent part:

> I believe the audit process is nearing completion. I also believe that all field work for the Company's international operations is complete. With the exception of certain tax issues, all significant audit issues known to me have been resolved. I have no reason to believe that these remaining issues will not be resolved in the near future. The Company's auditors are in the process of completing a quality review of their audit and must also complete procedures relating to financial reporting. I understand, however, that the Company's independent registered public accounting firm may, as a result of their continuing review, raise additional audit issues not known to me as of the date of this declaration. In addition, the Company is continuing to consult with its independent registered public accounting firm with respect to certain financial reporting issues related to the Company's return to compliance. 12/ (emphasis added).

11/ Rule of Practice 452 permits a party to adduce new evidence on appeal if the party shows "with particularity" that the evidence is "material" and that there were "reasonable grounds for failure to adduce such evidence previously." 17 C.F.R. § 201.452. The Division submitted a response stating that it did not object to the introduction of this additional evidence. We have determined to grant the motion.

12/ The supplemental declaration also stated that Nature's Sunshine's audit committee had formally engaged Deloitte to audit its financial statements for the fiscal year ended December 31, 2007. Nature's Sunshine has represented that it has engaged Deloitte to audit its financial statements for the fiscal year ended December 31, 2008.

On October 7, 2008, Nature's Sunshine filed its delinquent Forms 10-K for the fiscal years ended December 31, 2006 and December 31, 2007. 13/ On December 31, 2008, Nature's Sunshine filed an amended 2007 Form 10-K and Forms 10-Q for the quarters ended March 31, 2008, June 30, 2008, and September 30, 2008. None of the 2008 Forms 10-Q had been filed previously, and all of them were overdue. 14/

In light of the Company's October 7, 2008 filings, on November 14, 2008, we ordered the parties to submit supplemental briefs. We also requested and received a brief from the Division of Corporation Finance ("Corporation Finance") as amicus curiae. In its supplemental brief, Nature's Sunshine represented that its 2006 and 2007 Forms 10-K covered the reporting periods required for each of those years. Nature's Sunshine also represented that the 2006 Form 10-K included a restatement of fiscal year 2004 financial statements, as well as audited financial statements for fiscal years 2005 and 2006, neither of which were previously filed with the Commission; however, the 2005 interim financial information in the 2006 Form 10-K was restated from the interim financial information previously filed in Forms 10-Q for the quarters ended on March 31, June 30, and September 30, 2005. Nature's Sunshine further represented that the 2007 Form 10-K contained audited financial statements for fiscal years 2005, 2006, and 2007.

III.

Exchange Act Section 13(a) requires issuers of securities registered under Exchange Act Section 12 to file periodic and other reports with the Commission. 15/ Exchange Act Rules 13a-1 and 13a-13 require issuers to file annual and quarterly reports. 16/ "Compliance with those requirements is mandatory and may not be subject to conditions from the

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13/ Oral argument in this case was originally scheduled for October 1, 2008, but was subsequently cancelled and rescheduled to January 7, 2009.

14/ Nature's Sunshine has filed another Rule 452 motion seeking admission into evidence of the amended 2007 Form 10-K and the three 2008 Forms 10-Q. As Nature's Sunshine properly notes in the motion, however, Rule of Practice 323 permits us to take official notice of, among other things, "any matter in the public official records of the Commission." 17 C.F.R. § 201.323. Accordingly, we take official notice of Nature's Sunshine's filings pursuant to Rule 323, and deny the motion on that basis.

15/ 15 U.S.C. § 78m(a).

16/ 17 C.F.R. §§ 240.13a-1, 13a-13.

registrant." 17/ It is undisputed that Nature's Sunshine failed to file quarterly reports containing financial statements that had been reviewed by its independent auditors for the quarters ended September 30, 2005, March 31, 2006, June 30, 2006, September 30, 2006, and March 31, 2007; failed to file an annual report for the fiscal year ended December 31, 2005; and failed timely to file its annual report for the fiscal year ended December 31, 2006. Based on these filing failures, we conclude that Nature's Sunshine violated Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 13a-13.

Exchange Act Section 12(j) authorizes the Commission, "as it deems necessary or appropriate for the protection of investors," to suspend for a period not exceeding twelve months, or revoke, the registration of a security if it finds that the issuer of such security has failed to comply with any provision of the Exchange Act or its rules and regulations. 18/ In determining the appropriate sanction, we are guided by our analysis in Gateway International Holdings, Inc. 19/ In Gateway, we held that our determination of what sanctions will ensure that investors are adequately protected "turns on the effect on the investing public, including both current and prospective investors, of the issuer's violations, on the one hand, and the Section 12(j) sanctions, on the other hand." 20/ We also set forth a list of non-exclusive factors to be considered in making this determination, including the seriousness of the issuer's violations, the isolated or recurrent nature of the violations, the degree of culpability involved, the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and the credibility of its assurances, if any, against further violations. 21/ After carefully considering these factors, we conclude that the protection of public investors requires revocation of the registration of Nature's Sunshine's common stock.

Nature's Sunshine's violations were serious. Nature's Sunshine's failures to file required periodic reports deprived investors of accurate, complete, and timely information about the Company's operations and financial condition between 2005 and 2007. In addition, Nature's Sunshine indicated in a Form 8-K filed on March 20, 2006 that its financial statements from 2002 onward could not be relied on. Investors thus were without current, accurate information about the Company from that point to October 7, 2008, when Nature's Sunshine belatedly filed its 2006 and 2007 Forms 10-K. As we stated in Gateway,

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17/ America's Sports Voice, Inc., Securities Exchange Act Rel. No. 55511 (Mar. 22, 2007), 90 SEC Docket 879, 885.

18/ 15 U.S.C. 78*l*(j). Nature's Sunshine requests that we reverse the law judge's initial decision and dismiss this Exchange Act Section 12(j) proceeding.

19/ Exchange Act Rel. No. 53907 (May 31, 2006), 88 SEC Docket 430.

20/ 88 SEC Docket at 439.

21/ Id.

[the] [f]ailure to file periodic reports violates a central provision of the Exchange Act. The purpose of the periodic filing requirements is to supply investors with current and accurate financial information about an issuer so that they may make sound decisions. Those requirements are the primary tools which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities. Proceedings initiated under Exchange Act Section 12(j) are an important remedy to address the problem of publicly traded companies that are delinquent in the filing of their Exchange Act reports, and thereby deprive investors of accurate, complete, and timely financial information upon which to make informed investment decisions. 22/

Nature's Sunshine's violations were recurrent. Nature's Sunshine failed to file seven required filings over the course of the two-year period in the OIP. Subsequent to that period, Nature's Sunshine failed to file when due four required filings, and completely failed to file two more required filings. 23/ Nature's Sunshine's filing failures are repeated, numerous, and extend over a lengthy period of time. We reject the Company's argument in its brief that its failure to file required periodic reports was "an isolated occurrence resulting from a single series of undisputed events." Whether Nature's Sunshine's failures to file were due to one or several causes, we view them as recurrent and not isolated in nature. 24/

As to the degree of culpability involved, Nature's Sunshine notes that the law judge found that scienter was absent. We need not find that Nature's Sunshine was aware of, or intentionally ignored, its reporting obligations because scienter is not required to establish an issuer's liability under Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and

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22/ Id. at 441; see also Eagletech Commc'n, Inc., Exchange Act Rel. No. 54095 (July 5, 2006), 88 SEC Docket 1225, 1230.

23/ We take official notice that, since July 12, 2007, the date the OIP issued, Nature's Sunshine failed to file its quarterly reports for the quarters ended June 30, 2007 and September 30, 2007. Nature's Sunshine also failed timely to file its quarterly reports for the quarters ended March 31, 2008, June 30, 2008, and September 30, 2008, and its annual report for the fiscal year ended December 31, 2007.

24/ Impax Labs., Inc., Exchange Act Rel. No. 57864 (May 23, 2008), 93 SEC Docket 6241, 6251 (holding that issuer's failure to file two annual and six quarterly reports over an eighteen-month period was serious and recurrent where respondent claimed that its filing failures stemmed from an inability to complete the process of developing a new accounting method for the recognition of revenues under an agreement with another company) & n.25 (collecting cases). During oral argument, Nature's Sunshine's counsel conceded that not only were its reporting violations serious, but they were also recurrent.

13a-13. 25/ Nonetheless, there is no evidence, and Nature's Sunshine does not argue, that its failure to file was inadvertent. Nature's Sunshine admitted that it knew of its reporting obligations; yet it failed to file seven required periodic reports due between June 2005 and July 2007. 26/ Nature's Sunshine also knew of the requirement that it notify the Commission of its inability to file a Form 10-K or 10-Q; yet it filed only one such notice during this period. 27/

Moreover, Nature's Sunshine has previously underestimated the amount of time needed to become compliant. At the August 2007 prehearing conference, Nature's Sunshine reiterated that the Company's "goal" was to return to compliance by October 15, 2007, despite statements in a March 2007 Form 12b-25 indicating that such a "goal" was not realistic. At the September 2007 prehearing conference, Nature's Sunshine indicated that it was unlikely it would become compliant by October 15, 2007. Nature's Sunshine also offered that it was "more realistic" to expect the audit to be completed by the end of October 2007. Nature's Sunshine did not return to compliance on October 15, 2007, nor was the audit completed in October 2007.

Nature's Sunshine has made efforts to ensure future compliance, but its efforts to remedy its past violations have been inadequate. The Company has filed only one of the seven delinquent reports covered by the OIP -- a 2006 Form 10-K filed on October 7, 2008 during the pendency of this appeal, and that Form 10-K is materially deficient and in noncompliance with Exchange Act Section 13(a), as described below. Nature's Sunshine has yet to file a 2005 Form 10-K, any 2006 or 2007 Forms 10-Q, and a Form 10-Q that has been reviewed by independent auditors for the quarter ended September 30, 2005. In addition, the Company's failure to file its required periodic reports continued after Deloitte's engagement, the institution of this administrative proceeding, the law judge's initial decision, and up to the oral argument. 28/

25/ See America's Sports Voice, 90 SEC Docket at 883 n.12; Gateway, 88 SEC Docket at 439 n.28.

26/ See, e.g., Gateway, 88 SEC Docket at 439 (finding that issuer's failure to file seven required periodic reports due between May 2003 and December 2004 evidenced a "high degree of culpability").

27/ We take official notice that Nature's Sunshine filed a Form 12b-25 notification for its 2006 Form 10-K on March 19, 2007. Although the OIP did not allege, and we do not find, violations based on the Company's failure to file Forms 12b-25, we may consider those failures, as well as other matters that fall outside the OIP, in assessing appropriate sanctions. Gateway, 88 SEC Docket at 440 n.30.

28/ See America's Sports Voice, Inc., Admin. Proc. File No. 3-12329 (June 6, 2007) (Order Denying Motion for Reconsideration) at p. 3 n.12; America's Sports Voice, 90 SEC Docket at 886 n.21.

Nature's Sunshine's last-minute filings before oral argument do not alter our conclusion that revocation is appropriate. The 2006 Form 10-K filed on October 7, 2008 is materially deficient because it fails to comply with the management report requirement contained in Item 308(a) of Regulation S-K. 29/ Item 308(a) requires companies like Nature's Sunshine to include in their annual report on Form 10-K a report of management on the company's internal control over financial reporting as of the end of the fiscal year. 30/ Nature's Sunshine's 2006 Form 10-K disclosed that management was unable to complete its assessment of internal control over financial reporting as of December 31, 2006. The failure of the Company's management to complete its assessment of internal control over financial reporting (which caused Deloitte to issue a scope limitation in its attestation report) renders the 2006 Form 10-K materially deficient and in noncompliance with Exchange Act Section 13(a). 31/

In addition, both the 2006 and 2007 Forms 10-K are materially deficient because they do not satisfy the explicit disclosure requirements of Form 10-K. 32/ For example, in Note 17 to the 2006 Form 10-K financial statement notes, "Summary of Quarterly Operations," Nature's Sunshine included a table that presents the unaudited interim consolidated statements of operations for each fiscal quarter in 2006 and 2005. As noted in the table, the consolidated statements of operations and earnings per share for the quarters ended March 31, 2005, June 30,

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29/ 17 C.F.R. § 229.308(a); see also Compliance and Disclosure Interpretation, Question 115.02 (Regulation S-K) (expressing the view, with respect to the filing obligation of non-accelerated filers, that the failure to provide management's report on internal control over financial reporting in Form 10-K "renders the annual report materially deficient," and that, as a result, "the company would not be timely or current in its Exchange Act reporting"; further stating that the failure to provide management's report "would result in the company not being eligible to file new Form S-3 or Form S-8 registration statements and the loss of the availability of Rule 144"), available at: www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.

30/ For accelerated filers (public float of $75 million or more), such as Nature's Sunshine, compliance with this requirement began from the company's first fiscal year ending on or after November 15, 2004. See Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Securities Act Rel. No. 8392 (Feb. 24, 2004), 82 SEC Docket 796, 796.

31/ We note that, while Nature's Sunshine represented to the Commission that the quarterly information in the 2006 and 2007 Forms 10-K filed on October 7, 2008 has been reviewed by its independent auditors, the investing public remains unaware of that fact.

32/ By filing an amended 2007 Form 10-K on December 31, 2008, Nature's Sunshine sought to correct errors and address deficiencies identified by Corporation Finance in its amicus brief with respect to the 2007 Form 10-K filed on October 7, 2008. We express no view on the sufficiency of the amended 2007 Form 10-K.

2005, and September 30, 2005 have been restated from previously filed unaudited consolidated financial statements. While Nature's Sunshine's tabular presentation is acceptable under Item 302 of Regulation S-K, 33/ the narrative disclosure that "restatement adjustments are described in Note 2" does not meet the requirements of Item 302(a)(2) to reconcile the amounts given with those previously reported and describe the reason for the difference. Also, the amount and type of adjustments related to the restatement of 2005 amounts are not disclosed in Note 2.

Furthermore, Nature's Sunshine's operations in foreign countries are material and may be subject to foreign currency exchange rate risk, yet the Company does not provide the necessary quantitative and qualitative disclosures of this risk, as required by Item 7A of Form 10-K and Item 305 of Regulation S-K. 34/ Instead, the only disclosure Nature's Sunshine provides is the statement: "Given the uncertainty of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of operations, or financial condition."

Nature's Sunshine has accepted responsibility for its reporting violations and sought to become current in its recent filing obligations. However, the Company has yet to return to full compliance with the Exchange Act's reporting requirements. Nature's Sunshine already has needed "substantially more time than anticipated" to remedy its many delinquencies, "making us unconvinced that it is realistic to expect that the Company can become current entirely in its reporting obligations in the foreseeable future." 35/ The need for finality in Commission administrative proceedings provides further justification for our conclusion that revocation is necessary and appropriate in the public interest to protect investors. 36/

IV.

Nature's Sunshine has raised numerous arguments against revocation, but none of those arguments has any merit. Nature's Sunshine argues that revocation is unwarranted because there is no evidence that its reporting violations are related to an ongoing fraud or a manipulation. As discussed, an issuer's failure to comply with the reporting requirements is a serious violation of the Exchange Act because such conduct deprives the investing public of accurate, complete, and

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33/ 17 C.F.R. § 229.302.

34/ 17 C.F.R. § 229.305.

35/ Impax, 93 SEC Docket at 6254.

36/ See e-Smart Techs., Inc., 57 S.E.C. 964, 970-71 n.18 (2004) (stating that the need for finality in Commission administrative proceedings is a consideration in the determination whether to revoke an issuer's securities registration).

timely information upon which to make informed investment decisions. 37/ In fact, in our recent decision in Impax Laboratories, Inc., 38/ we held that the respondent's recurrent failure to file its periodic reports (eight filings over an eighteen-month period) was "so serious" a violation of the Exchange Act that only a "strongly compelling showing" regarding the other Gateway factors would justify a sanction less than revocation. 39/ We found that the respondent in Impax had failed to make such a showing and ordered revocation of the respondent's securities registration. Similarly, here, we find that revocation is warranted.

Nature's Sunshine argues that revocation is unwarranted because it is not a "shell company," but a "healthy, viable company with substantial revenues, assets, and operations." In rejecting a substantially similar argument in Gateway, we stated, "Our observation in e-Smart [Technologies, Inc., 57 S.E.C. 964, 969 n.14 (2004)] about the utility of revocation under Section 12(j) against 'shell companies' should not be construed as indicating that such a sanction is not appropriate when the issuer is not a shell company." 40/

Nature's Sunshine argues that revocation is unwarranted because it will harm existing shareholders. We have stated that any harm to existing shareholders is not the determining factor in evaluating whether an issuer's securities registration should be revoked. We have also stated that existing and prospective shareholders alike are harmed where, as here, the required filings about the issuer are not available and, as a result, existing and prospective shareholders cannot make informed investment decisions:

37/ The fact that the OIP does not allege fraudulent or manipulative conduct in connection with an issuer's failure to file required periodic reports does not diminish the seriousness of the reporting violations. Cf. Impax, 93 SEC Docket at 6252 (rejecting issuer's argument that revocation was not warranted because its filing failures were "not as serious as, for example, filing reports that are false and misleading"; stating that, while the filing of false and misleading reports is a serious matter, such conduct is addressed by the additional sanctions available for violation of the antifraud provisions). In its brief, Nature's Sunshine acknowledges that "any violation of the Exchange Act's reporting requirements is indeed serious."

38/ Exchange Act Rel. No. 57864 (May 23, 2008), 93 SEC Docket 6241.

39/ Id. at 6252.

40/ Gateway, 88 SEC Docket at 444 n.45; see also Impax, 93 SEC Docket at 6255-56 (stating that "[t]he absence of financial statements, particularly in the case of an apparently expanding company with demonstrated growth objectives, deprives all investors of the required timely information, thereby hampering their ability to make informed investment decisions").

We previously have recognized, however, that, in any deregistration, current shareholders could be harmed by a diminution in the liquidity and value of their stock by virtue of the deregistration. We also have held that the extent of any harm that may result to existing shareholders cannot be the determining factor in our analysis. In evaluating what is necessary or appropriate to protect investors, regard must be had not only for existing stockholders of the issuer, but also for potential investors. Indeed, we have emphasized the significant interests of prospective investors who can be substantially hindered in their ability to evaluate an issuer in the absence of current filings. In any event, both existing and prospective investors are harmed by the continuing lack of current and reliable information for the Company. 41/

Nature's Sunshine argues that existing and prospective investors would be best served by our imposing no sanction against the Company and dismissing this proceeding. We find that this argument minimizes the central importance of the Exchange Act's reporting requirements, 42/ suggesting that Nature's Sunshine "does not [fully] appreciate the significant public policy objectives the requirements are intended to serve, i.e. providing the public, particularly current and prospective shareholders, with material, timely, and accurate information about an issuer's business." 43/ Dismissal of this proceeding against Nature's Sunshine, despite its numerous filing delinquencies and unresolved deficiencies, would significantly detract from the Exchange Act's reporting requirements. Dismissal also would reward those issuers who fail to file required periodic reports when due over an extended period of time, become the subject of Exchange Act Section 12(j) revocation proceedings, and then, on the eve of hearings before the law judge or, in this case, oral argument on appeal, make last-minute filings in an effort to bring themselves current with their reporting obligations, while prolonging indefinitely the period during which public investors would be without accurate, complete, and timely reports (that comply with the requirements of the Exchange Act and its rules and regulations) to make informed investment decisions.

41/ America's Sports Voice, 90 SEC Docket at 885-86 (internal quotations and footnotes omitted).

42/ As the United States Supreme Court stated nearly twenty-five years ago, "[c]orporate financial statements are one of the primary sources of information available to guide the decisions of the investing public." United States v. Arthur Young & Co., 465 U.S. 805, 810 (1984).

43/ America's Sports Voice, 90 SEC Docket at 885 (finding that respondent's offer to return to compliance if Commission granted a "90-day window" reflected "highly troubling attitude" toward Exchange Act's reporting requirements).

Nature's Sunshine argues that the Commission's 2004 decision in e-Smart Technologies, Inc. 44/ provides "useful guidance" in this case. However, in our view, e-Smart fails to support Nature's Sunshine's position. In e-Smart, the law judge revoked the registration of e-Smart's securities for failure to make timely annual and quarterly filings. In ordering revocation, the law judge rejected as overly optimistic e-Smart's claim that it intended to bring itself into full compliance with the Exchange Act's reporting requirements and submit audited financial statements by a certain date. Shortly after the law judge issued her decision, e-Smart filed audited annual reports, as it represented that it would. The Commission was concerned that a premise underlying the law judge's initial decision -- that e-Smart could not submit audited reports as represented -- "no longer appeared valid." 45/ The Commission determined to remand the proceedings to enable the law judge to re-evaluate her decision in light of e-Smart's subsequent filings. The Commission cautioned, however, that its decision was "dependent on the particular facts and circumstances involved, and should not be construed as suggesting that a determination to revoke an issuer's registration will be reconsidered simply because the issuer has returned to reporting compliance and begun to submit long overdue filings." 46/ Here, Nature's Sunshine's conduct after the law judge's opinion has not invalidated any material premise in that opinion or our own analysis.

Nature's Sunshine argues that revocation is a "draconian" sanction that operates as a "corporate death penalty." However, as Nature's Sunshine's counsel acknowledged at oral argument, upon revocation, the Company may re-register its securities under Exchange Act Section 12(g) by filing a Form 10 with the Commission. 47/ The Form 10 would require Nature's Sunshine to provide financial statements for periods that are already covered by the Company's previously filed periodic reports. 48/ Counsel also represented at oral argument that

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44/ 57 S.E.C. 964 (2004).

45/ Id. at 965.

46/ Id. at 970-71 n.18.

47/ 15 U.S.C. § 78*l*(g).

48/ See generally Regulation S-X , 17 C.F.R. § 210. The Form 10 would not need to contain the disclosure required by Item 308 of Regulation S-K because that disclosure is not required by the Form.

the Company would be able to file a Form 10. Revocation is a necessary and appropriate remedy to protect investors in view of the Company's past and ongoing reporting violations. Revocation will further the public interest by reinforcing the importance of full and timely compliance with the Exchange Act's reporting requirements. 49/ An appropriate order will issue. 50/

By the Commission

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

49/ We reject Nature's Sunshine's argument that the law judge effectively applied a standard of strict liability by relying "almost exclusively" on the Company's failure to predict a "date certain" by which it would return to compliance and by making such failure a prerequisite for avoiding revocation. A fair reading of the initial decision reveals that the law judge neither relied on the Company's failure to provide a "date certain" nor required the Company to make such a showing. Rather, the law judge evaluated each of the factors outlined in Gateway before deciding that revocation was in the public interest. Like the law judge, we have carefully considered and weighed the Gateway factors, taking into account all of Nature's Sunshine's arguments.

50/ 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. 59268 / January 21, 2009

Admin. Proc. File No. 3-12684

In the Matter of

NATURE'S SUNSHINE PRODUCTS, INC.

c/o William H. Kimball
E. Andrew Southerling
W. Brad Nes
David A. Sirignano
Morgan, Lewis & Bockius LLP
1111 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that the registration of all classes of the registered securities of Nature's Sunshine Products, Inc. under Section 12(g) of the Securities Exchange Act of 1934, be, and it hereby is, revoked pursuant to Exchange Act Section 12(j).

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59277 / January 22, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2920 January 22, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13347

In the Matter of **Cablevision Systems Corporation,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Cablevision Systems Corporation ("Cablevision" 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 Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing 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:

Summary

1. Cablevision Systems Corporation is a Delaware corporation located in Bethpage, New York. It is a diversified entertainment and telecommunications company with a market capitalization of approximately $8.05 billion in 2007 and 2007 annual revenues of $6.484 billion. Cablevision's stock is registered under Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

2. Rainbow Media Holdings, Inc. ("Rainbow"), during the relevant period, was a subsidiary of Cablevision that owned interests in and managed national and regional entertainment programming networks, the Madison Square Garden sports and entertainment business and cable television advertising sales companies. At all relevant times, the financial statements of Rainbow and its majority-owned businesses were consolidated into Cablevision's financial reports.

3. From at least 1999 through mid-2003, contrary to Generally Accepted Accounting Principles ("GAAP"), Cablevision recognized certain costs as current expenses when, in fact, the costs should not have been recognized in those periods. These improper "prepays," as the practice was referred to, occurred because certain Cablevision managers and employees, most significantly within Rainbow, falsified invoices and other documents in order to accrue expenses earlier than when they in fact should have been accrued. These improperly recognized expenses were reflected in Cablevision's books, records and accounts and caused Cablevision to overstate expenses in earlier fiscal periods, and understate expenses in later periods.

4. Separately, from at least 2000 through late 2003, contrary to GAAP, Cablevision improperly recognized payments known as launch and marketing support (hereinafter collectively "launch support"), which were paid to Cablevision by television program vendors for advertising and marketing campaigns to attract viewers to the vendors' programs. These errors occurred in and directly affected financial reporting for Cablevision's cable distribution business. The improper timing of the recognition of launch support was reflected in Cablevision's books, records and accounts and caused Cablevision to reduce expenses in the periods in which launch support was improperly recognized and correspondingly increase expenses in the periods when the launch support should have been recognized.

5. The improper recognition of prepays and launch support payments caused Cablevision's reports to the Commission to be materially inaccurate. These errors, among others,

[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.

caused Cablevision in 2004 to restate its financial statements for the years 2000 through 2002 and for the nine months ended September 30, 2003. The improper recognition of prepaid expenses and launch support payments in Cablevision's books and records was possible because during the relevant period Respondent lacked sufficiently robust internal controls.

Improper Prepays

6. Cablevision delegated to the corporation's individual business units the authority to incur expenses and authorize payments. A corporate, centralized accounting department recorded expenses in Cablevision's books and records and issued checks for payments. Cablevision's accounting department, however, had little direct knowledge of the type of details discussed below at a business unit level. Internal accounting procedures merely called for recognition of expenses and requests for payment of expenses to be reported to the accounting department on a standardized "authorization for payment" form ("APF"), signed by the appropriate level business unit manager, with evidence of the expense, such as an invoice, attached. These controls, however, were not sufficient to prevent the manipulation of expense recognition that occurred.

7. Certain Cablevision employees and managers for years were able to defeat Cablevision's internal accounting controls using methods that were neither particularly devious nor sophisticated. For example, some employees submitted counterfeit invoices to Cablevision's accounting department that were of noticeably poor quality, and were different in appearance from legitimate invoices. Certain Cablevision employees also asked vendors to submit false, vague or misdated invoices for services not yet provided. These invoices were used to submit fraudulent APFs to Cablevision's accounting department in support of early expense recognition and payments. In addition, Cablevision checks were sometimes sent to the business unit from which a counterfeit or false invoice originated, ostensibly for delivery to the vendor by an employee of the business unit. This deficient practice permitted the business unit to hold payment until the anticipated services were actually rendered.

8. The circumstances described above demonstrate that Cablevision's internal controls, including employee training, were inadequate during the relevant period and failed to provide reasonable assurance that transactions were executed as authorized by management, or that transactions were properly recorded so that Cablevision's financial statements could be prepared in accordance with GAAP and accountability for assets could be maintained.

Improper Launch Support Recognition

9. Beginning in the middle to late 1990s, television program vendors began providing lump-sum launch support payments to Cablevision in connection with multi-year contracts with Cablevision to carry their programs. Contract provisions concerning launch support payments were generally understood to require Cablevision to use the funds for advertising and marketing campaigns to attract viewers to the vendors' programs. Contracts providing for large up-front payments of launch support to Cablevision were not uncommon. These contracts sometimes also

required that the launch support be refunded by Cablevision if, among other things, it dropped the program.

10. In some cases during the relevant period, Cablevision properly recognized non-refundable launch support as a reduction of expenses ratably over the life of the contract with the vendor and recognized refundable launch support ratably over the life of the refund period. In fact, in 2002, Cablevision publicly stated that this was how it accounted for launch support. From 2000 through the third quarter of 2003, however, Cablevision improperly accelerated the recognition of launch support received from several program vendors, rather than recognizing it ratably over the life of the contract or the refund period. This early recognition ran contrary to its general practice and its 2002 public statement, and violated GAAP's matching principle.

11. For example, after the first two years of an eight-year contract, Cablevision changed its recognition for $15.16 million of launch support from recognition ratably over the life of the contract to immediate recognition of the remaining balance. Under the circumstances, however, Cablevision should have accounted for launch support payments ratably over the life of the contract where, as here, the contract term was fixed and there was no obligation to refund launch support. Another example involved a contract with a launch support refund period. After the first eight months of a 24 month refund period, Cablevision changed its recognition of $5.3 million in launch support from recognition ratably over the life of the refund period to immediate recognition of the remaining balance. Under the circumstances, however, Cablevision should have accounted for launch support ratably over the refund period specified in the contracts.

12. Cablevision also improperly recognized launch support early by treating a 2002 seven-year agreement to carry certain programs as if it were two agreements – one of three years, and another of seven years. As two separate agreements, Cablevision recognized $48 million in launch support over the 'three year' agreement (approximately $16 million per year), and recognized $16 million in launch support over the 'seven year' agreement (approximately $2.28 million per year). Under GAAP, however, the two agreements should have been treated as one agreement, with the result that the total $64 million in launch support should have been recognized ratably over seven years, i.e., approximately $9.14 million per year. The purported two agreements were negotiated simultaneously and dated only five days apart, and the 'seven year' agreement also amended the terms of the 'three year' agreement. Cablevision employees improperly cast the single deal as two agreements to achieve early recognition of the launch support payments.

13. The accelerated recognition of launch support revealed further that Cablevision's internal accounting controls were insufficient to permit the preparation of its financial statements in conformity with GAAP. Cablevision personnel were, but should not have been, able to make unchecked changes to the scheduled recognition of launch support.

Cablevision Financial Misstatements

14. As a result of the improper expense recognition discussed above, Cablevision's financial statements in its annual reports on Form 10-K and its quarterly reports on Forms 10-Q for

the years 2000 through 2002 and the nine months ended September 30, 2003 were materially inaccurate. As reported in Cablevision's 2004 restatement, the sum of the launch support and the expense recognition errors resulted in a $15.184 million overstatement of expenses in 2000, a $25.389 million understatement of expenses in 2001, and a $7.581 million understatement of expenses in 2002. For the first 9 months of 2003, the sum of the errors in expense and launch support recognition resulted in a $7.895 million understatement of expenses. The combined errors resulted in (net of estimated tax) a 3.8% understatement of Cablevision's net income in 2000, a 1.5% overstatement of net income in 2001, a 4.9% overstatement of net income in 2002 and a 5.1% understatement of Cablevision's net loss in the nine months ended September 30, 2003.

Violations

15. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act to file periodic reports with the Commission containing complete and accurate financial information presented in accordance with GAAP. Exchange Act Rule 12b-20 further requires that periodic reports contain such further material information, if any, as may be necessary to make the required statements not misleading.

16. Section 13(b)(2)(A) of the Exchange Act requires issuers of securities registered pursuant to Exchange Act Section 12 to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the issuer. Section 13(b)(2)(B)(ii) of the Exhange Act requires reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

17. As a result of the conduct described above, Respondent violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13.

Cablevision's Remedial Efforts

18. In determining to accept Respondent's Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

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

Accordingly, it is hereby ORDERED that, pursuant to Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59278 / January 22, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2921 / January 22, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13348

In the Matter of Catherine R. McEnroe, Noreen O'Loughlin and Martin R. von Ruden, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Catherine R. McEnroe, Noreen O'Loughlin and Martin R. von Ruden ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer 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 Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

25 of 36

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

1. Cablevision Systems Corporation ("Cablevision") is a Delaware corporation located in Bethpage, New York. Cablevision is a diversified entertainment and telecommunications company with a market capitalization of approximately $8.05 billion in 2007 and 2007 annual revenues of $6.484 billion. Cablevision's stock is registered under Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

2. Rainbow Media Holdings, Inc. ("Rainbow"), during the relevant period, was a subsidiary of Cablevision that owned interests in and managed national and regional entertainment programming networks, the Madison Square Garden sports and entertainment business and cable television advertising sales companies. At all relevant times, the financial statements of Rainbow and its majority-owned business units were consolidated into Cablevision's financial reports.

3. AMC Networks, during the relevant period, was a business unit of Rainbow. It included at least two sub-units, including the television programming networks known as AMC (formerly known as American Movie Classics Company) and WE: Women's Entertainment ("WE").

4. Respondent Catherine R. McEnroe served as president of AMC Networks from April 1996 through June 2003, when she left Cablevision in connection with the matters described herein.

5. Respondent Noreen O'Loughlin served as Executive Vice President and General Manager of Marketing of AMC Networks from April 1998 to July 2000, and as Executive Vice President and General Manager of AMC from January 2002 through June 2003, when she left Cablevision in connection with the matters described herein.

6. Respondent Martin R. von Ruden served as Senior Vice President and General Manager of WE from 1998 until late 2000, and as Executive Vice President and General Manager of WE from late 2000 until June 2003, when he left Cablevision in connection with the matters described herein.

Improper Prepays

7. From at least 1999 through mid-2003, contrary to Generally Accepted Accounting Principles ("GAAP"), Cablevision recognized certain costs as current expenses when, in fact, the costs should not have been recognized in those periods. These improper "prepays," as the practice was referred to, occurred because employees prepared and submitted inaccurate and misleading invoices and other documents in order to accrue expenses earlier than when they in fact should have been accrued. These improperly recognized expenses were reflected in Cablevision's books, records and accounts and caused Cablevision to overstate expenses in

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

earlier fiscal periods and understate expenses in later periods. As a result, Cablevision's reports to the public and the Commission for the period 1999 through mid-2003 were inaccurate, causing Cablevision in 2004 to restate its financial statements for 2000 through the nine months ended September 30, 2003.

8. A large part of these improper prepays occurred at business units of Cablevision's Rainbow subsidiary, namely AMC Networks and its sub-units AMC and WE. AMC Networks prematurely recognized, and caused Cablevision to improperly recognize, expenses totaling approximately $12 million in both 1999 and 2000, $10 million in 2001 and $9 million in 2002.

9. While Respondents worked at AMC Networks or its sub-units, their subordinates used several different improper means to recognize expenses in a current period that properly should have been recognized in a later period. For example, the subordinates asked vendors to submit misdated invoices for vaguely defined services, which had not yet been rendered, and used these invoices to achieve early expense recognition and payment. These invoices were submitted to Cablevision's accounting department with Authorization for Payment Forms ("APF"), in some cases signed by Respondents, that inaccurately identified the expenses as current expenses. In addition, AMC Networks employees on occasion asked Cablevision's accounting department to send checks to the employees, ostensibly for delivery by the employee to the vendor. This practice permitted AMC Networks employees to hold payment until anticipated services were actually rendered, in violation of fundamental internal accounting controls. The purpose of these prepay practices was to provide a "margin of error" each year for meeting AMC Networks' internally budgeted allowance for expenses.

10. Respondent McEnroe, while serving as President of AMC Networks, directed and was aware of improper prepays and signed inaccurate APFs that caused improper prepays. These prepays resulted in Cablevision overstating expenses in earlier fiscal periods and understating expenses in later periods and rendered inaccurate Cablevision's financial reports to the Commission and the public for the years 1999 through mid-2003.

11. Respondent O'Loughlin, while serving as Executive Vice President and General Manager of Marketing of AMC Networks and as Executive Vice President and General Manager of AMC, directed and was aware of improper prepays and signed inaccurate APFs that caused improper prepays. These prepays resulted in Cablevision overstating expenses in earlier fiscal periods and understating expenses in later periods and rendered inaccurate Cablevision's financial reports to the Commission and the public for the years 1999 through mid-2003.

12. Respondent von Ruden, while serving as Senior Vice President and General Manager of WE and as Executive Vice President and General Manager of WE, directed and was aware of improper prepays and signed inaccurate APFs that caused improper prepays. These prepays resulted in Cablevision overstating expenses in earlier fiscal periods and understating expenses in later periods and rendered inaccurate Cablevision's financial reports to the Commission and the public for the years 1999 through mid-2003.

Violations

13. Section 13(b)(5) of the Exchange act provides that no person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls, or knowingly falsify any book, record or account described in Section 13(b)(2) of the Exchange Act.

14. Exchange Act Rule 13b2-1 prohibits any person from, directly or indirectly, falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

15. As a result of the conduct as found by the Commission, Respondents violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder.[2]

IV.

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

Accordingly, it is hereby ORDERED that pursuant to Section 21C of the Exchange Act, Respondents cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder.

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

[2] This matter is related to a civil action, Securities and Exhange Commission v. Catherine McEnroe, Noreen O'Loughlin and Martin von Ruden, to be filed in United States District Court for the Eastern District of New York, in which Respondents have consented to pay civil penalties as follows: Respondent McEnroe - $30,000, Respondent O'Loughlin - $15,000, and Respondent von Ruden - $15,000.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

JAN 2 2 2009

In the Matter of:	:	
BBJ Environmental Technologies, Inc.	:	ORDER OF SUSPENSION OF TRADING
500-1	:	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of BBJ Environmental Technologies, Inc. ("BBJ Technologies") because it has not filed a periodic report since its 10-QSB/A for the quarterly period ending September 30, 2004, filed on April 6, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of BBJ Technologies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in BBJ Technologies securities is suspended for the period from 9:30 a.m. EST on January 22, 2009, through 11:59 p.m. EST on February 4, 2009.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

26 of 36

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
January 22, 2009

Administrative Proceeding File No. 3-13346

In the Matter of: BBJ Environmental Technologies, Inc. Respondent.	:	ORDER INSTITUTING PUBLIC PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission's ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against BBJ Environmental Technologies, Inc. (CIK No. 0000839439) ("BBJ Technologies" or "Respondent").

II.

As a result of its investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. BBJ Technologies is a Nevada corporation headquartered in Tampa, Florida. BBJ Technologies has had a class of securities registered with the Commission pursuant to Section 12(g) of the Exchange Act since May, 2, 1994, at which time it filed a Form 8-A Exchange Act registration statement registering its common stock under Section 12(g). Prior to that time, BBJ Technologies was reporting pursuant to a reporting obligation based on Section 15(d) of the Exchange Act. BBJ Technologies' stock is currently quoted on the Pink Sheets operated by Pink OTC Markets Inc. under the trading symbol "BBJE."

B. DELINQUENT PERIODIC FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

3. Since April 6, 2006, when it filed an amended Form 10-QSB for the quarterly period ending September 30, 2004, and while its securities have been registered with the Commission, BBJ Technologies has failed to make any of its periodic reports required by Section 13(a) and Rules 13a-1 and 13a-13 of the Exchange Act.

4. As a result of the foregoing, BBJ Technologies has failed to comply with Section 13(a) and Rules 13a-1 and 13a-13 of the Exchange Act.

III.

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

A. Whether the allegations contained in Section II of this Order are true, and to afford BBJ Technologies an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary or appropriate for the protection of investors to suspend for a period not exceeding twelve months, or to revoke the registration of each class of BBJ Technologies' securities identified in Section II of this Order registered pursuant to Section 12 of the Exchange Act.

IV.

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

IT IS FURTHER ORDERED that the Respondent shall file an answer to the allegations contained in the Order Instituting Proceedings within ten days after service of this Order as provided by Rule 220 of the Commission's Rules of Practice [17 C.F.R. § 201.220].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified or registered mail or by other means of verifiable delivery.

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

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

By the Commission.

Elizabeth M. Murphy
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. 59296 / January 26, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2926 / January 26, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13350

In the Matter of **Jordan H. Mintz,** **Respondent.**	**ORDER INSTITUTING PUBLIC 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 Jordan H. Mintz ("Respondent" or "Mintz") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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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 . . . attorney . . . who has been by name . . . [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent 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, and the findings contained in Section III(1) and (3) below, which are admitted, Respondent consents to the entry of this Order Instituting Public 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. Mintz, 52, is and has been an attorney licensed to practice in the States of Texas and New York. From January 1996 until October 2000, Mintz was a Vice President in the Tax Division of Enron Corp. ("Enron"). In October 2000, Mintz became the General Counsel of Enron Global Finance, a position he held during the charged conduct and maintained until February 2002. Mintz is currently a Vice President and the Chief Tax Officer in the Tax Department of the Finance Division at Kinder Morgan. Neither the Tax Department, nor the Finance Division are part of, or report to, the General Counsel's Office at Kinder Morgan. Mintz does not provide any legal advice in his current position, does not supervise any employees that provide legal advice as part of the General Counsel's Office at Kinder Morgan, and is not required to be an attorney to serve in his current position. Mintz plans to remain in his current position and perform the same duties following settlement of this matter.

2. Enron was, at all relevant times, an Oregon corporation with its principal place of business in Houston, Texas. Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based upon reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. Enron also created and traded financial products. At all relevant times, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange.

3. On January 20, 2009, the U.S. District Court for the Southern District of Texas, Houston Division, entered a final judgment by consent against Mintz, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(b)(5) and 14(a) of the Exchange Act and Exchange Act Rules 10b-5, 13b2-1, 13b2-2 and 14a-9, and aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13. Securities and Exchange Commission v. Jordan H. Mintz, et al., Civil Action Number H-07-1027 (S.D. Tex.). Mintz was also ordered to pay $1 in disgorgement and a $25,000 civil money penalty.

4. Among other things, the Commission's complaint alleges that Mintz and co-defendant Rex R. Rogers, the former Associate General Counsel for Enron, intentionally failed to disclose in Enron's 2000 proxy statement millions of dollars paid to the former Chief Financial Officer, Andrew Fastow. The complaint further alleges that Mintz completed a fraudulent related party transaction with an entity controlled by Fastow and failed to disclose the transaction when required in Enron's 2000 proxy statement. The complaint also alleges that Mintz and Rogers made misleading statements regarding the Fastow related entities in Enron's second quarter Form 10-Q.

IV.

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

Accordingly, IT IS HEREBY ORDERED, effective immediately, that Mintz is suspended from appearing or practicing before the Commission as an attorney for two years. Before appearing and resuming practice before the Commission as an attorney, Mintz must submit an affidavit to the Commission's Office of the General Counsel truthfully stating, under penalty of perjury, that he has complied with this Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
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. 59297 / January 26, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2927 / January 26, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13351

In the Matter of **Rex R. Rogers,** **Respondent.**	**ORDER INSTITUTING PUBLIC 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 Rex R. Rogers ("Respondent" or "Rogers") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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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 . . . attorney . . . who has been by name . . . [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent 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, and the findings contained in Section III(3) below, which are admitted, Respondent consents to the entry of this Order Instituting Public 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. Respondent Rogers, 59, is and has been an attorney licensed to practice in the State of Texas. Rogers, a former enforcement attorney for the Commission from 1979 through 1984, was hired in 1985 by Houston Natural Gas, the predecessor of Enron Corp. ("Enron"). In 1997, Rogers was promoted to Vice President and Associate General Counsel of Enron with shared responsibility for the timing and content of Commission filings. Rogers remained in that position until 2003, following Enron's bankruptcy, and has not been employed since 2003.

2. Enron was, at all relevant times, an Oregon corporation with its principal place of business in Houston, Texas. Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based upon reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. Enron also created and traded financial products. At all relevant times, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange.

3. On January 20, 2009, the U.S. District Court for the Southern District of Texas, Houston Division, entered a final judgment by consent against Rogers, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933, Sections 10(b) and 14(a) of the Exchange Act and Exchange Act Rules 10b-5 and 14a-9, and aiding and abetting violations of Sections 13(a) and 16(a) of the Exchange Act, and Exchange Act Rules 12b-20, 13a-1, 13a-13, 16a-2 and 16a-3. Securities and Exchange Commission v. Jordan H. Mintz, et al., Civil Action Number H-07-1027 (S.D. Tex.). Rogers was also ordered to pay $1 in disgorgement and a $25,000 civil money penalty.

4. Among other things, the Commission's complaint alleges that Rogers and co-defendant Jordan H. Mintz, the former General Counsel for Enron Global Finance, intentionally failed to disclose in Enron's 2000 proxy statement millions of dollars paid to the former Chief Financial Officer, Andrew Fastow. The complaint further alleges that Rogers failed to disclose $16 million realized through insider stock sales by Enron's former Chairman, Kenneth Lay, in

Enron's 2000 Proxy Statement, and aided and abetted Lay's failure to disclose an additional $70 million in stock sales in Lay's Form 4 filings with the Commission.

IV.

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

Accordingly, IT IS HEREBY ORDERED, effective immediately, that Rogers is suspended from appearing or practicing before the Commission as an attorney for two years. Before appearing and resuming practice before the Commission as an attorney, Rogers must submit an affidavit to the Commission's Office of the General Counsel truthfully stating, under penalty of perjury, that he has complied with this Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
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. 59303 / January 27, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13353

In the Matter of **ARTHUR P. HIPWELL,** **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 Arthur P. Hipwell ("Respondent" or "Hipwell"), pursuant to Rules 102(e)(1)(i) and 102(e)(2) of the Commission's Rules of Practice.[1]

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

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[1] Rule 102(e)(1)(i) provides in relevant part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter: (i) Not to possess the requisite qualifications to represent others * * *.

Rule 102(e)(2) provides in relevant part, that:

> Any attorney who has been suspended or disbarred by a court of the United States or of any State; * * * shall be forthwith suspended from appearing or practicing before the Commission.

these proceedings, which is 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. Hipwell, age 59, was from 1976 until January 10, 1985 an attorney licensed to practice in the State of Kentucky.

2. On January 10, 1985, Hipwell was suspended from the practice of law by the Kentucky Supreme Court for non-payment of dues to the Kentucky Bar Association. From that date to the present, Hipwell has not been licensed to practice law in any jurisdiction within the United States.

3. Nonetheless, during most of the period since January 10, 1985, including a continuous period from August 1, 1999 until about April 15, 2007, Hipwell held himself out as an attorney, by representing that he was "Senior Vice President and General Counsel" of Humana, Inc., a public company required to make certain filings with the Commission. Hipwell repeated this representation by signing many of Humana's Commission filings, including numerous Forms 10-Q and 8-K, with "Senior Vice President and General Counsel" as his title.

4. Although he was not licensed to practice law, Hipwell engaged in conduct that constitutes appearing and practicing before the Commission as an attorney, including advising Humana regarding whether the federal securities laws or Commission rules required it to make certain filings with the Commission, and preparing and/or providing advice regarding numerous documents that Humana filed with the Commission.

5. Accordingly, Hipwell lacks the requisite qualifications to represent others before the Commission as defined in Rule 102(e)(1)(i) and has been suspended from the practice of law by a court as defined in Rule 102(e)(2).

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that Hipwell is forthwith suspended from and denied the privilege of appearing or practicing before the Commission as an attorney for one year from the date of this Order. Furthermore, before appearing or resuming practice before the Commission, Respondent must submit an application for reinstatement to the Commission's Office of the General Counsel that includes an affidavit truthfully stating, under penalty of perjury, that he has complied with this Order, that he is presently admitted to the practice law in at least one state or the District of Columbia and in good standing in that jurisdiction, that he is not the subject of any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 28, 2009

In the Matter of **Future Canada China Environment 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 Future Canada China Environment Inc. Questions have arisen concerning recent trading activity in the company's stock during which its share price increased from $0.92 to $28.50. Questions have also arisen concerning the accuracy and adequacy of publicly available information regarding its potential acquisition of another company. Future Canada China Environment Inc., a company that has made public filings with the Commission, is quoted on the OTC Bulletin Board and Pink Sheets operated by Pink OTC Markets Inc. under the ticker symbol "FCCE."

The Commission is of the opinion that the public interest and the protection of the 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 above-listed company is suspended for the period from 9:30 a.m. EST, January 28, 2009, through 11:59 p.m. EST, on February 10, 2009.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59295 / January 26, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2924 / January 26, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13349

In the Matter of **John V. Cracchiolo, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against John V. Cracchiolo ("Respondent" or "Cracchiolo") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

[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 the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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 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. John V. Cracchiolo, age 52, is and has been a certified public accountant licensed to practice in the State of California. He served as Chief Financial Officer and Chief Operations Officer of Endocare, Inc. from June 2001 until his resignation on March 3, 2003.

2. Endocare was, at all relevant times, a Delaware corporation with its principal place of business in Irvine, California. Endocare developed and distributed medical devices for use in the treatment of various types of cancers and urological ailments. At all relevant times, Endocare's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and was listed on the NASDAQ National Market until January 16, 2003, when it was delisted for Endocare's failure to file its periodic reports with the Commission.

3. On January 13, 2009, a final judgment was entered against Cracchiolo, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Paul W. Mikus, et al., Civil Action Number SACV06-734 JVS (MLGx), in the United States District Court for the Central District of California. Cracchiolo was also ordered to pay $60,715 in disgorgement of ill-gotten gains while participating in the fraud, and $10,378.69 in prejudgment interest, and a $50,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Cracchiolo engaged in a fraudulent scheme which resulted in Endocare filing materially false and misleading periodic reports for the second and third quarters of 2001, the year end 2001, and the first and second quarters in 2002, and registration statements filed on November 14, 2001 and March 26, 2002. As a result of the scheme, Endocare also issued misleading press releases and Forms 8-K in December 2002 and March 2003. The Complaint alleged that Cracchiolo overstated Endocare's revenue and income by booking false sales, engaging in improper revenue recognition practices, and improperly understating or delaying the recognition of expenses in order to inflate Endocare's earnings. The Complaint also alleged that during conference calls with Wall Street securities analysts, Cracchiolo misled investors about the number of procedures that were preformed using Endocare-owned boxes.

IV.

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

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

A. John V. Cracchiolo is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59317 / January 29, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2928 / January 29, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13355

In the Matter of **Michelle V. Nguyen (CPA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Michelle V. Nguyen ("Respondent" or "Nguyen") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

[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 the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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.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. Nguyen, age 48, is and has been a certified public accountant licensed to practice in the States of California and Maryland.

2. Meridian Holdings, Inc. ("Meridian") was, at all relevant times, a Colorado corporation with its principal executive offices in Culver City, California. In 2004, Meridian maintained its principal executive office in Los Angeles, California and its common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and listed on the NASDAQ Bulletin Board.

3. On September 28, 2007, the Commission filed a complaint against Nguyen in SEC v. Meridian Holdings, Inc., et al., Case No. CV 07-06335 DDP (SSx) (C.D. Cal.). On January 6, 2009, the court entered an order permanently enjoining Nguyen, by consent, from violating Section 10(b) of the Exchange Act, and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 12b-20 and 13a-13 thereunder. Nguyen was also ordered to pay a $15,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that during the 2004 calendar year, Nguyen acted as Meridian's principal financial officer and interim chief financial officer for purposes of Meridian's public filings with the Commission and prepared the condensed consolidated financial information included in Meridian's quarterly reports filed with the Commission. The Commission's complaint further alleged that Nguyen, at the direction of Meridian's Chief Executive Officer and Chairman of the Board, participated in a fraudulent scheme which resulted in materially false and misleading financial statements being included in Meridian's quarterly reports on Form 10-QSB for the second and third quarters of 2004. The Commission's complaint also alleged that Nguyen engaged in improper accounting practices that materially increased Meridian's quarterly revenue and net income in a departure from generally accepted accounting principles ("GAAP"). These practices included, among other things, creating the condensed consolidated financial statements included in Meridian's second and third quarter 2004 Forms 10-QSB filed with Commission, which included, as assets and income, a $30 million default judgment award plus accumulated interest thereon. By recognizing the default judgment and interest thereon as income in its 2004 second and third quarter reports, Meridian reported positive earnings per share for each quarter. Absent the default judgment and interest, Meridian would have reported losses per share for each quarter.

Additionally, the Commission's complaint alleged Nguyen caused Meridian to record the default judgment and interest thereon as a $31 million asset on Meridian's balance sheets, resulting in the default judgment constituting 85% of Meridian's total assets. The Commission's complaint alleged that the inclusion of the default judgment and interest in Meridian's financial statements was both contrary to GAAP and materially false and misleading because Nguyen had no reasonable basis to conclude that that Meridian would be able to collect any, let alone all, of the default judgment and interest.

IV.

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

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

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

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

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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which she is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges her responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Aguilar
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 230, 232, 239, 240 and 249

[Release Nos. 33-9002; 34-59324; 39-2461; IC-28609; File No. S7-11-08]

RIN 3235-AJ71

Interactive Data to Improve Financial Reporting

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting rules requiring companies to provide financial statement information in a form that is intended to improve its usefulness to investors. In this format, financial statement information could be downloaded directly into spreadsheets, analyzed in a variety of ways using commercial off-the-shelf software, and used within investment models in other software formats. The rules will apply to public companies and foreign private issuers that prepare their financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP), and foreign private issuers that prepare their financial statements using International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Companies will provide their financial statements to the Commission and on their corporate Web sites in interactive data format using the eXtensible Business Reporting Language (XBRL). The interactive data will be provided as an exhibit to periodic and current reports and registration statements, as well as to transition reports for a change in fiscal year. The new rules are intended not only to make financial information easier for investors to analyze, but also to assist in automating regulatory filings and business information processing. Interactive data has the potential to increase the speed, accuracy and usability of financial disclosure, and eventually reduce costs.

EFFECTIVE DATE: [Insert date 60 days after publication in the Federal Register] except §232.406T is effective from [insert date 60 days after publication in the Federal Register] until October 31, 2014.

FOR FURTHER INFORMATION CONTACT: Mark W. Green, Senior Special Counsel (Regulatory Policy), Division of Corporation Finance at (202) 551-3430; Craig E. Slivka, Special Counsel, Division of Corporation Finance at (202) 551-3430; Jeffrey W. Naumann, Assistant Director, Office of Interactive Disclosure at (202) 551-5352; or Jeffrey Ellis, Professional Accounting Fellow, Office of the Chief Accountant at (202) 551-5300, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adding Rules 405 and 406T to Regulation S-T,[1] and revising Item 601[2] of Regulation S-K,[3] Rules 11,[4] 201,[5] 202,[6] 305,[7] 401,[8] and 402[9] of

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[1] 17 CFR 232.10 et seq.

[2] 17 CFR 229.601.

[3] 17 CFR 229.10 et seq.

[4] 17 CFR 232.11.

[5] 17 CFR 232.201.

[6] 17 CFR 232.202.

[7] 17 CFR 232.305.

[8] 17 CFR 232.401.

[9] 17 CFR 232.402.

Regulation S-T, Rule 144[10] under the Securities Act of 1933 (Securities Act),[11] and Rules 12b-25,[12] 13a-14[13] and 15d-14[14] under the Securities Exchange Act of 1934 (Exchange Act).[15] We also are revising Forms S-3,[16] S-8,[17] F-3,[18] F-9[19] and F-10[20] under the Securities Act and Forms 10-Q,[21] 10-K,[22] 12b-25,[23] 20-F,[24] 40-F[25] and 6-K[26] under the Exchange Act.

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[10] 17 CFR 230.144.

[11] 15 U.S.C. 77a et seq.

[12] 17 CFR 240.12b-25.

[13] 17 CFR 240.13a-14.

[14] 17 CFR 240. 15d-14.

[15] 15 U.S.C. 78a et seq.

[16] 17 CFR 239.13.

[17] 17 CFR 239.16b.

[18] 17 CFR 239.33.

[19] 17 CFR 239.39.

[20] 17 CFR 239.40.

[21] 17 CFR 249.308a.

[22] 17 CFR 249.310.

[23] 17 CFR 249.322.

[24] 17 CFR 249.220f.

[25] 17 CFR 249.240f.

[26] 17 CFR 249.306.

TABLE OF CONTENTS

VI. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

VII. STATUTORY AUTHORITY AND TEXT OF AMENDMENTS

I. INTRODUCTION AND BACKGROUND

A. Introduction

On May 30, 2008, we issued a release in which we proposed for public comment amendments requiring companies to provide their financial statements to the Commission and on their corporate Web sites in interactive data format using XBRL.[27] In this release, we are adopting the amendments substantially as proposed, but with the modifications discussed below.

Over the last several decades, developments in technology and electronic data communication have facilitated greater transparency in the form of easier access to, and analysis of, financial reporting and disclosures. Technological developments also have significantly decreased the time and cost of filing disclosure documents with us. Most notably, in 1993 we began to require electronic filing on our Electronic Data Gathering, Analysis and Retrieval

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[27] We proposed the amendments in Release No. 33-8924 (May 30, 2008) [73 FR 32794]. The comment letters we received in response to the proposing release were filed in File Number S7-11-08 and are available at http://www.sec.gov/comments/s7-11-08/s71108.shtml or from our Public Reference Room at 100 F Street, NE, Washington, DC 20549.

System (EDGAR).[28] Since then, widespread use of the Internet has vastly decreased the time and expense of accessing disclosure filed with us.

We continue to update our filing standards and systems as technologies improve. These developments assist us in our goal to promote efficient and transparent capital markets. For example, since 2003 we have required electronic filing of certain ownership reports[29] filed on Forms 3,[30] 4,[31] and 5[32] in a format that provides interactive data, and recently we adopted similar rules governing the filing of Form D.[33] In addition, recently we have encouraged, and in some cases required, public reporting companies and mutual funds to provide disclosures and communicate with investors using the Internet.[34] Now, as part of our continuing efforts to assist investors who use Commission disclosures, as well as filers of that disclosure, we are adopting

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[28] In 1993, we began to require domestic issuers to file most documents electronically. Release No. 33-6977 (Feb. 23, 1993) [58 FR 14628]. Electronic filing began with a pilot program in 1984. Release No. 33-6539 (June 27, 1984) [49 FR 28044].

[29] Release No. 33-8230 (May 7, 2003) [68 FR 25788 and 37044 (correction)] (required electronic filing of ownership reports) and Release No. 33-8891 (Feb. 6, 2008) [73 FR 10592] (required electronic filing of Form D [17 CFR 239.500]).

[30] 17 CFR 249.103 and 274.202.

[31] 17 CFR 249.104 and 274.203.

[32] 17 CFR 249.105.

[33] 17 CFR 239.500.

[34] See, e.g., Release No. 34-56135 (July 26, 2007) [72 FR 42222]; Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148]; Release No. 34-52056 (July 19, 2005) [70 FR 44722]; Release No. 33-8861 (November 21, 2007) [72 FR 67790]; and Release No. 34-57172 (Jan. 18, 2008) [73 FR 4450].

rules to require that financial statements be provided in a format that makes the information they contain interactive.

Our adoption of the new rules is consistent with the recently announced plan to replace the EDGAR system with the Interactive Data Electronic Applications (IDEA) system. Based on a completely new architecture being built from the ground up, it will at first supplement and then eventually replace the EDGAR system. IDEA will facilitate the use and analysis of information submitted to the Commission in interactive data format.[35]

The new rules build on our voluntary filer program, started in 2005,[36] that allowed us to evaluate certain uses of interactive data. The Commission has evaluated interactive data from an investor's perspective in several ways, including holding a roundtable focused on investor/analyst needs from interactive data, meeting with various investor focused data service providers to understand the ways in which interactive data could improve their ability to serve investors, and, at the staff level, experimenting with analysis capabilities using the Commission's viewer and other existing XBRL software. The voluntary program allows companies to submit financial statements on a supplemental basis in interactive format as exhibits to specified filings under the Exchange Act and the Investment Company Act of 1940 (Investment Company Act).[37]

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[35] Press Release No. 2008-179 (Aug. 19, 2008).

[36] Release No. 33-8529 (Feb. 3, 2005) [70 FR 6556].

[37] 15 U.S.C. 80a-1 et seq.

Companies that participate in the program still are required to file their financial statements in American Standard Code for Information Interchange (ASCII) or HyperText Markup Language (HTML).[38] In 2007, we extended the program to enable mutual funds voluntarily to submit in interactive data format supplemental information contained in the risk/return summary section of their prospectuses.[39] Over 100 companies have participated in the voluntary program. These companies span a wide range of industries and company characteristics, and have a total public float of over $2 trillion.

Interactive data can create new ways for investors, analysts, and others to retrieve and use financial information in documents filed with us. For example, users of financial information will be able to download it directly into spreadsheets, analyze it using commercial off-the-shelf software, or use it within investment models in other software formats. Through interactive data, what is currently static, text-based information can be dynamically searched and analyzed, facilitating the comparison of financial and business performance across companies, reporting periods, and industries.

Interactive data also provide a significant opportunity to automate regulatory filings and business information processing, with the potential to increase the speed, accuracy, and usability of financial disclosure. Such automation could eventually reduce costs. A company that uses a

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[38] HTML is a standardized language commonly used to present text and other information on Web sites.

[39] Release No. 33-8823 (July 11, 2007) [72 FR 39290].

standardized interactive data format at earlier stages of its reporting cycle could reduce the need for repetitive data entry and, therefore, the likelihood of human error. In this way, interactive data may improve the quality of information while reducing its cost.

Also, to the extent investors currently are required to pay for access to annual or quarterly report disclosure that has been extracted and reformatted into an interactive data format by third-party sources, the availability of interactive data in Commission filings will allow investors to avoid additional costs associated with third party sources.

We believe that requiring issuers to file their financial statements using interactive data format will enable investors, analysts, and the Commission staff to capture and analyze that information more quickly and at less cost than is possible using the same financial information provided in a static format. Any investor with a computer and an internet connection will have the ability to acquire and download interactive financial data that have generally been available only to large institutional users. The new interactive data requirements will not change disclosure requirements under the federal securities laws and regulations, but will add a requirement to include financial statements in a new interactive data format as an exhibit. Thus, the requirement that filers provide financial statements using interactive data will not otherwise alter at all the disclosure or formatting standards of periodic or other reports,[40] registration

[40] These reports include reports on Forms 8-K and 6-K that either are required to be filed as a result of information regarding specified events or are filed voluntarily to disclose other information.

statements,[41] or transition reports.[42] These filings will continue to be available as they are today for those who prefer to view the traditional text-based document.

We received 79 comment letters relating to the proposing release from domestic and foreign commenters including investor groups, pension funds, corporations, accounting and law firms, vendors and service providers, individuals, and corporate, professional and trade associations. Many commenters generally supported the proposed requirement to submit financial information in interactive data format, but many also expressed concern about specific aspects of the proposed rules including, in particular, the proposed phase-in requirement, detailed tagging of footnotes and liability related to the interactive data file. The final amendments adopt the rules substantially as proposed, with some changes to address issues expressed in the comment letters. We discuss specific comments where applicable throughout this release.

B. Current Filing Technology and Interactive Data

Companies filing electronically are required to file their registration statements, quarterly, annual and current reports, and transition reports in ASCII or HTML format.[43] Also, to a limited

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[41] Unless otherwise stated, when we refer to registration statements, we mean registration statements filed under the Securities Act.

[42] Transition reports generally must be filed when an issuer changes its fiscal closing date. The transition report covers the resulting transition period between the closing date of its most recent fiscal year and the opening date of its new fiscal year. See Rules 13a-10 [17 CFR 240.13a-10] and 15d-10 [17 CFR 240.15d-10]. Unless otherwise stated, when we refer to Exchange Act reports, periodic reports, or "reports," we mean quarterly and annual periodic reports as well as transition reports.

[43] Rule 301 under Regulation S-T [17 CFR 232.301] requires electronic filings to comply with the EDGAR Filer Manual, and Section 5.1 of the Filer Manual requires that electronic filings be in ASCII or HTML format. Rule 104

degree, our electronic filing system uses other formats for internal processing and document-type identification. For example, our system uses eXtensible Markup Language (XML) to process reports of beneficial ownership of equity securities on Forms 3, 4, and 5 under Section 16(a) of the Exchange Act.[44]

Electronic formats such as HTML, XML, and XBRL are open standards[45] that define or "tag" data using standard definitions. The tags establish a consistent structure of identity and context. This consistent structure can be recognized and processed by a variety of different software applications. In the case of HTML, the standardized tags enable Web browsers to present Web sites' embedded text and information in predictable format. In the case of XBRL, software applications, such as databases, financial reporting systems, and spreadsheets, recognize and process tagged financial information. XBRL was derived from the XML standard. It was developed and continues to be supported by XBRL International, a consortium of approximately 550 organizations representing many elements of the financial reporting community worldwide. XBRL U.S., the international organization's U.S. jurisdiction representative, is a non-profit

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under Regulation S-T [17 CFR 232.104] permits filers to submit voluntarily as an adjunct to their official filings in ASCII or HTML unofficial PDF copies of filed documents. Unless otherwise stated, we refer to filings in ASCII or HTML as traditional format filings.

[44] 15 U.S.C. 78p(a).

[45] The term "open standard" is generally applied to technological specifications that are widely available to the public, royalty-free, at minimal or no cost.

organization[46] that includes companies, public accounting firms, software developers, filing agents, data aggregators, stock exchanges, regulators, financial services companies, and industry associations.[47] In 2006, the Commission contracted with XBRL U.S. to develop the taxonomy or standard list of tags necessary for financial reporting in interactive format consistent with U.S. GAAP and Commission regulations.[48] In developing the taxonomy, XBRL US, which is responsible for the content of the taxonomy, included items required by US GAAP and the Commission's regulations, however they also included other items that are commonly used by companies in their financial statements. In addition to undergoing a public review and comment period, the taxonomy was reviewed by the staff of the Financial Accounting Standards Board (FASB) and the Commission. The FASB staff is involved in the process for creating and reviewing tags for new accounting pronouncements as they are published and in the future the draft tags may even be published with the accounting standard. Currently, the Commission has a contract with XBRL U.S. to develop the standard list of tags for the risk/return summary section of mutual fund prospectuses and the schedule of investments for investment companies.

Financial reporting in interactive format requires a standard list of tags. These tags are

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[46] XBRL U.S. is a 501(c)(6) organization. Internal Revenue Code section 501(c)(6) applies to "Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual." See 26 U.S.C 501(c)(6).

[47] XBRL U.S. supports efforts to promote interactive financial and business data specific to the U.S., including U.S. GAAP.

[48] That contract has been completed.

similar to definitions in an ordinary dictionary, and they cover a variety of financial concepts that can be read and understood by software applications. For financial statements prepared in accordance with U.S. GAAP, a filer will use the list of tags for U.S. financial statement reporting.[49] This list of tags contains descriptive labels, definitions, authoritative references to U.S. GAAP and Commission regulations where applicable, and other elements, all of which provide the contextual information necessary for interactive data[50] to be recognized and processed by software.[51]

Data tags are applied to financial statements by using commercially available software that guides a preparer to tag information in the financial statements with the appropriate tags in the standard list. Each element in the standard list of tags has a standard label. A company can therefore match the standard labels to each caption in its financial statements. Occasionally, because filers have considerable flexibility in how financial information is reported under U.S. reporting standards, it is possible that a company may wish to use a non-standard financial

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[49] Unless stated otherwise, when we refer to the "list of tags for U.S. financial statement reporting" we mean the interactive data taxonomy as approved by XBRL U.S. that is based on U.S. GAAP, Commission regulations, and common financial reporting practices used in the preparation of financial statements in the U.S.

[50] The new rules define the interactive data in machine-readable format required to be submitted as the "interactive data file," which will be required with every interactive data submission. See §232.11 of Regulation S-T.

[51] For example, contextual information will identify the entity to which it relates, usually by using the filer's CIK number. A hypothetical filer converting its traditional electronic disclosure of $1,000,000 of net sales would have to create interactive data that identify what the 1,000,000 represents, net sales, and the currency in which it is disclosed, dollars. The contextual information will include other information as necessary; for example, whether it

statement line item that is not included in the standard list of tags. In this situation, a company will create a company-specific element, called an extension.[52] For example, what a company identifies in its traditional format financial statements as "operating revenues" may be associated with an element that has "net revenues" as the standard label. In this situation, a company will need to change, or extend, the standard label to become "operating revenues" when it tags that disclosure with the element.[53] A company may choose to tag its own financial statements using commercially available software, or it may choose instead to outsource the tagging process.

By the same process, a filer that prepares its financial statements in accordance with IFRS as issued by the IASB[54] will use the IFRS list of tags to create its interactive

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relates to an annual report or quarterly report, the financial reporting period, continuing or discontinued operations, or actual, restated, forecast, pro forma or other type of disclosure.

[52] In other cases, without a relevant and appropriate tag in the list of tags, a company will be required to create an extension in order to provide interactive data that are equivalent to the corresponding portion of the traditional format filing.

[53] Unless otherwise stated, extensions, whether relating to an element or a label, are not part of the standard list of tags.

[54] As used in this release, the phrase "IFRS as issued by the IASB" refers to the authoritative text of IFRS, which, according to the Constitution of the International Accounting Standards Committee Foundation (IASCF), is published in English. See "International Financial Reporting Standards, including International Accounting Standards and Interpretations as at 1 January 2007," Preface to International Financial Reporting Standards, at paragraph 23. See http://www.iasb.org/xbrl/index.html. The IASCF released the 2008 taxonomy (list of tags) on March 31, 2008. See IASB Press Release, The IASC Foundation publishes IFRS Taxonomy 2008, (March 31, 2008). Following a 60-day public consultation period, the IASCF published the final list of tags in June 2008. See IASB Press Release IASC Foundation publishes IFRS Taxonomy 2008 (June 24, 2008). Recently, the IASC published the IFRS Taxonomy Guide. See IASB Press Release, The IASC Foundation publishes the IFRS Taxonomy Guide (August 28, 2008).

data-formatted financial statements.[55] The IFRS list of tags contains descriptive labels, authoritative references to IFRS where applicable, and other elements and concepts that provide the contextual information necessary for interactive data to be recognized and processed by software. The IASCF has developed the IFRS list of tags. To create interactive data using the IFRS list of tags, an issuer generally will need to follow the same mapping, extension and tagging process as will a company that uses the list of tags for U.S. financial statement reporting. As further discussed below, the IASCF is collaborating with XBRL U.S. and other parties to align the U.S. GAAP and IFRS lists of tags to make them more interoperable and comparable. This collaboration involves the development of the appropriate scope for the IFRS list of tags' content and technology architecture and currently totals 2,700 IFRS tags.

Because financial statements in interactive data format are intended to be processed by software applications, the unprocessed data are not readable by humans. Thus, viewers are necessary to convert or "render" the interactive data file to human readable format. Some viewers are similar to Web browsers used to read HTML files.

The Commission's Web site currently provides links to viewers that allow the public to easily read company disclosures submitted using interactive data. These viewers are intended to demonstrate the capability of software to present interactive data in human-readable form and to provide open source software to give developers a free resource they can use as is or build upon.

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[55] Unless stated otherwise, when we refer to the "IFRS list of tags" we mean the list of tags for financial statements

As noted above, software also is able to process interactive data so as to automate and, as a result, facilitate access to and analysis of tagged data. In addition, we are aware of other applications under development that may provide additional and advanced functionality.

C. The Commission's Multiyear Evaluation of Interactive Data and Overview of New Rules

In 2004, we began to assess the benefits of interactive data and its potential to improve the timeliness and accuracy of financial disclosure and analysis of Commission filings.[56] As part of this evaluation, we adopted rules in 2005 that permitted filers, on a voluntary basis, to provide financial disclosure in interactive data format as an exhibit to certain filings on our electronic filing system. The voluntary program has been based on an earlier version of the list of tags for U.S. financial statement reporting, which does not include a full array of standard elements for financial statement footnotes and schedules. After more than two years of increasing participation, 100 companies have chosen to provide interactive data financial reporting.[57]

During this time, we have kept informed of technology advances and other interactive data developments. We note that several U.S. and foreign regulators have begun to incorporate

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prepared in accordance with IFRS as issued by the IASB.

[56] Press Release No. 2004-97 (July 22, 2004).

[57] A viewer for the voluntary program is available at http://www.sec.gov/spotlight/xbrl/xbrlwebapp.shtml. This viewer maintains a running total of companies and filers submitting data as part of the voluntary program. As of January 2, 2009, 125 companies had submitted over 540 interactive data reports.

interactive data into their financial reporting systems.[58] In the U.S., the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, and the Office of the Comptroller of the Currency (OCC) require the use of XBRL.[59] Since 2006, approximately 8,200 U.S. financial institutions have been using XBRL to submit quarterly reports to banking regulators.[60] Internationally, countries that require or have instituted voluntary or pilot programs for XBRL financial reporting include Australia, Belgium, Canada, China, Denmark, France, Germany, Ireland, Israel, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Thailand and the United Kingdom.[61]

We also have kept informed of relevant advances and developments by hosting roundtables on the topic of interactive data financial reporting,[62] creating the Commission's

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[58] However, well-developed and widespread application of XBRL to financial reports used by investors is not yet the international norm. According to the commenter EuropeanIssuers, "XBRL is permitted or required by regulators . . . only . . . for certain reports filed with banking regulators or unconsolidated financial statements filed with the commercial registries [and] XBRL is not currently being used in Europe for financial reporting to investors." EuropeanIssuers is a non-profit pan-European organization formed when the European Association of Listed Companies and the Union of Issuers Quoted in Europe combined their organizations in 2008. The organization states that it represents the vast majority of publicly quoted companies in Europe.

[59] Since 2005, the FDIC, Federal Reserve, and the OCC have required the insured institutions that they oversee to file their quarterly Consolidated Reports of Condition and Income (called Call Reports) in interactive data format using XBRL. Call Reports, which include data about an institution's balance sheet and income statement, are used by these federal agencies to assess the financial health and risk profile of the financial institution.

[60] See Improved Business Process Through XBRL: A Use Case for Business Reporting, available at http://www.xbrl.org/us/us/FFIEC%20White%20Paper%2002Feb2006.pdf.

[61] See XBRL International Progress Report (November 2007), available at http://www.xbrl.org/ProgressReports/2007_11_XBRL_Progress_Report.pdf.

[62] See materials available at http://www.sec.gov/spotlight/xbrl/xbrl-meetings.shtml.

Office of Interactive Disclosure,[63] and meeting with international securities regulators to discuss, among other items, timetables for implementation of interactive data initiatives for financial reporting.[64] Also, staff of the Commission attended meetings of the Advisory Committee on Improvements to Financial Reporting (CIFiR) in which the committee discussed proposals for financial reporting using interactive data.[65] We also have reviewed written statements and public comments received by CIFiR on its XBRL developed proposal[66] that preceded its XBRL final recommendation.

Building on our experience from the voluntary program, and our participation in the other initiatives described above, we proposed rules to require financial reporting using interactive

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[63] Press Release No. 2007-213 (October 9, 2007).

[64] Press Release No. 2007-227 (November 9, 2007).

[65] For example, CIFiR conducted an open meeting on March 14, 2008 in which it heard reactions from an invited panel of participants to CIFiR's developed proposal regarding required filing of financial information using interactive data. An archived webcast of the meeting is available at http://sec.gov/about/offices/oca/cifir.shtml. The March 14, 2008 panelists presented their views and engaged with CIFiR members regarding issues relating to requiring interactive data tagged financial statements, including tag list and technological developments, implications for large and small public companies, needs of investors, necessity of assurance and verification of such tagged financial statements, and legal implications arising from such tagging. Also, CIFiR has provided to the Commission a Final Report that recommends that the Commission, over the long term, require the filing of financial information using interactive data once specified conditions are satisfied. See Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission (Aug. 1, 2008) (Final Report), available at http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf. CIFiR's recommendation is discussed more fully in Part II.B.2 below.

[66] See Progress Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission (Feb. 14, 2008) (Progress Report), available at http://www.sec.gov/rules/other/2008/33-8896.pdf. The XBRL developed proposal appears in chapter 4 of the Progress Report. Written statements of panelists at the March 14, 2008 meeting and public comments received on the Progress Report are available at http://sec.gov/comments/265-24/265-24.shtml.

data, and are now adopting those rules with the modifications discussed below. The rules will apply to domestic and foreign public companies that prepare their financial statements in accordance with U.S. GAAP, and foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB. Filers will be required to include an exhibit containing interactive data with their Securities Act registration statements, quarterly, if applicable, and annual reports, and transition reports, as well as reports on Forms 8-K[67] or 6-K that contain specified financial statements.[68] Filers also will be required to provide it on their company Web sites.[69] We believe requiring the submission and posting of interactive data has the potential to provide advantages for the investing public by making financial data more accessible, timely, inexpensive and easier to analyze.

By enabling filers to further automate their financial processes, interactive data may eventually help filers improve the timeliness of, and speed at which they generate, financial information, while reducing the cost of filing and potentially increasing the accuracy of the information. For example, with standardized interactive data tags, registration statements and

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[67] 17 CFR 249.308.

[68] The specified financial statements are discussed in detail in n. 74.

[69] The new rules will not include any investment company that is registered under the Investment Company Act or any "business development company," as defined in Section 2(a)(48) of that Act [15 U.S.C. 80a-2(a)(48)]. Business development companies are a category of closed-end investment companies that are not required to register under that Act. The new rules also will not include any entity that reports under the Exchange Act and prepares its financial statements in accordance with Article 6 of Regulation S-X [17 CFR 210.6-01 et seq.]. The new rules will not apply to these entities because the standard list of tags for investment management is under development.

periodic and current reports may require less time for information gathering and review. Also, standardized interactive data tagging may enhance the ability of an issuer's in-house financial professionals to identify and correct errors in the issuer's registration statements and periodic and current reports filed in traditional electronic format. Filers also may gain benefits not directly related to public financial disclosures. For example, filers that use interactive data may be able to consolidate enterprise financial information more quickly and potentially more reliably across operating units with different accounting systems. However, we recognize that at the outset, filers will most likely prepare their interactive data as an additional step after their financial statements have been prepared.

D. Summary of Adopted Amendments

The principal elements of the new rules are as follows:

- Domestic and foreign large accelerated filers[70] that use U.S. GAAP and have a worldwide public common equity float above $5 billion[71] as of the end of the second fiscal quarter of their most recently completed fiscal year[72] will provide to the

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[70] Exchange Act Rule 12b-2 [17 CFR 240.12b-2] generally defines "large accelerated filer" as an issuer that has common equity held by unaffiliated persons with a value of at least $700 million, has been subject to the Exchange Act's periodic reporting requirements for at least 12 months, has filed at least one annual report, and is not eligible to use the disclosure requirements available to smaller reporting companies for its periodic reports.

[71] The $5 billion cutoff will establish a category of approximately 500 filers that will be subject to the interactive data requirements in the first year.

[72] The proposing release at n. 89 stated our intention that the float measurement date be consistent with the measurement date for determining large accelerated filer status. Throughout the proposing release, however, we inadvertently characterized the measurement date as the end of the most recently completed second fiscal quarter

Commission a new exhibit.[73] The exhibit will be required with such filers' Securities Act registration statements, quarterly, if applicable, and annual reports, and transition reports, as well as reports on Form 8-K or Form 6-K that contain revised or updated financial statements.[74] The exhibit will contain the financial statements[75] and any applicable financial statement schedules in interactive data format. The requirement

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rather than the end of the second fiscal quarter of the most recently completed fiscal year. We now characterize the measurement date in the latter manner to conform it to our stated intention.

[73] Interactive data will be required as an exhibit to a Securities Act registration statement that contains financial statements, such as a Form S-1 [17 CFR 239.11], but not required in connection with an initial public offering. Interactive data will not be required as an exhibit to a Securities Act registration statement that does not contain financial statements, such as a Form S-3 or other form filed by an issuer that is eligible to and does incorporate by reference all required financial statements from its periodic reports. Also, interactive data will not be required as an exhibit to an Exchange Act registration statement.

[74] In connection with registration statements where historical financial statements are incorporated by reference, issuers often file under cover of Form 8-K or 6-K their revised audited annual financial statements when their previously filed annual financial statements are required to be revised, pursuant to applicable accounting standards, to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments, or a change in accounting principle. Also, foreign private issuers occasionally may file current interim financial statements pursuant to the nine-month updating requirement of Item 8.A.5 of Form 20-F under cover of Form 6-K which are incorporated by reference into a registration statement. In these circumstances, the interactive data exhibit will be required to be included in the Form 8-K or 6-K to accompany the traditional format financial statements to which they relate. Interactive data exhibits related to financial statements that have been restated to correct an accounting error will be required to be included in any amended registration statement or periodic report or transition report that contains the restated traditional format financial statements. The requirement to submit restated financial statements in interactive data format in such an instance would depend on whether the original filing contained financial statements for fiscal periods regarding which the filer was subject to the interactive data requirements. For instance, for those filers in the first phase-in period, the financial statements being restated would only have to be submitted in interactive data format if they were originally for fiscal periods ending on or after June 15, 2009.

[75] When we refer to financial statements, we mean the face of the financial statements and accompanying footnotes. The face of the financial statements refers to the statement of financial position (balance sheet), income statement, statement of comprehensive income, statement of cash flows, and statement of owners' equity, as required by Commission regulations. References to the financial statements as required for interactive data reporting include any required schedules to the financial statements, unless we expressly state otherwise.

will apply beginning with a periodic report on Form 10-Q, Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2009.

- All other domestic and foreign large accelerated filers using U.S. GAAP will be subject to the same interactive data reporting requirements the following year, beginning with a periodic report on Form 10-Q, Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2010.
- All remaining filers using U.S. GAAP, including smaller reporting companies,[76] and all foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB,[77] will be subject to the same interactive data reporting requirements beginning with a periodic report on Form 10-Q, Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2011.
- Filers that first become subject to the requirement to submit interactive data after year three (i.e., companies that become subject to our reporting requirements after the phase-in is complete), will first be required to submit an interactive data file for their

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[76] Item 10(f)(1) of Regulation S-K [17 CFR 229.10(f)(1)], Rule 405 under the Securities Act [17 CFR 230.405] and Rule 12b-2 under the Exchange Act [17 CFR 240.12b-2] define the term "smaller reporting company," in general, as a company that has common equity securities held by non-affiliates with a market value of less than $75 million or, if that value cannot be calculated, had less than $50 million in revenue in the prior fiscal year.

[77] The amendments will not require or permit foreign private issuers that prepare their financial statements in accordance with a variation of IFRS as issued by the IASB to provide interactive data.

first periodic report on Form 10-Q or first annual report on Form 20-F or Form 40-F, as applicable.

- The amendments will not alter the requirements to provide financial statements and any required financial statement schedules with the traditional format filings.
- Financial statements in interactive data format will be provided as exhibits identified in Item 601(b) of Regulation S-K and Forms F-9, F-10, 20-F, 6-K and 40-F.[78]
- Financial statement footnotes and financial statement schedules initially will be tagged individually as a block of text. After a year of such tagging, a filer also will be required to tag the detailed quantitative disclosures within the footnotes and schedules and will be permitted, but not required, to the extent they choose, to tag each narrative disclosure.
- The amendments will require the financial information and document and entity identifier elements, such as the form type, company name, and public float, to be tagged according to Regulation S-T and the EDGAR Filer Manual.[79]
- Interactive data exhibits will be required at the same time as the rest of the related

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[78] The adopted interactive data requirements would not apply to asset-backed filings because issuer financial statements are generally not required or provided in filings made pursuant to Regulation AB (17 CFR 229.1100 et seq.).

[79] New Rule 405 of Regulation S-T will directly set forth the basic tagging requirements and indirectly set forth the rest of the tagging requirements through the requirement to comply with the EDGAR Filer Manual. Consistent with new Rule 405, the Filer Manual will contain the technical tagging requirements.

report or Securities Act registration statement, except for the following two circumstances. The initial interactive data exhibit of a filer will be required within 30 days after the earlier of the due date or filing date of the related report or registration statement, as applicable. In year two, a filer will have a similar 30 day grace period for its first interactive data exhibit that includes detailed tagging of its footnotes and schedules.

- A filer required to provide financial statements in interactive data format to the Commission also will be required to post those financial statements in interactive data format on its corporate Web site not later than the end of the calendar day it filed or was required to file the related registration statement or report with the Commission, whichever is earlier.[80]
- Filers that do not provide or post required interactive data on the date required will be deemed not current with their Exchange Act reports and, as a result, will not be eligible to use the short Form S-3, F-3, or S-8, or elect under Form S-4 or F-4 to provide information at a level prescribed by Form S-3 or F-3. Similarly, such filers will not be deemed to have available adequate current public information for purposes

[80] The day the registration statement or report is submitted electronically to the Commission may not be the business day on which it was deemed officially filed. For example, a filing submitted after 5:30 p.m. generally is not deemed officially filed until the following business day. Under the new rules, the Web posting will be required at any time on the same calendar day that the related registration statement or report is deemed officially filed or required to be filed, whichever is earlier.

of the resale exemption safe harbor provided by Rule 144.[81] A filer that is deemed not current solely as a result of not providing or posting an interactive data exhibit when required will be deemed current upon providing or posting the interactive data. Therefore it will regain current status for purposes of short form registration statement eligibility, and determining adequate current public information under Rule 144. As such, it will not lose its status as having "timely" filed its Exchange Act reports solely as a result of the delay in providing interactive data.[82]

- Companies that are not required to provide interactive data until a later time will have the option to do so earlier and may provide interactive data at their discretion until required by the amendments. Such a company may also tag footnotes individually as a block of text until required to tag the detailed quantitative disclosures within the footnotes and schedules, but otherwise must follow the same requirements as those mandated and can only use a grace period for its initial submission and the initial detail-tagged-footnote submission, whether submitted voluntarily or as required by the amendments.
- Companies may cease voluntary submissions at any time and need not tag their financial data at a pace other than at which the rules otherwise would require.

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[81] 17 CFR 230.144.

[82] Filers that do not provide or post required interactive data on the date required with respect to a Securities Act filing will be deemed not current with their Exchange Act reports.

- The voluntary program rules will be modified to permit investment companies to participate, but to exclude non-investment company participation. As a result, the voluntary program will continue for the financial statements of investment companies that are registered under the Investment Company Act, and business development companies and other entities that report under the Exchange Act and prepare their financial statements in accordance with Article 6 of Regulation S-X. [83]
- An interactive data file generally will be subject to the federal securities laws in a modified manner similar to that of the voluntary program if the filer submits the interactive data file within 24 months of the time the filer first is required to submit interactive data files but no later than October 31, 2014. During the time a filer's interactive data files are treated in this modified manner, they will be
  - deemed not filed for purposes of specified liability provisions; and
  - protected from liability for failure to comply with the tagging requirements if the interactive data file failed to meet those requirements but the failure

[83] On December 17, 2008, the Commission voted to adopt rules requiring interactive data for the risk/return summary section of mutual fund prospectuses. See Press Release No. 2008-300 (December 18, 2008). See also Release No. 33-8929 (June 10, 2008) [73 FR 35442] (mutual fund proposing release).

occurred despite the filer's good faith effort and the filer corrected the failure promptly after becoming aware of it.[84]

- Also similar to the voluntary program, interactive data files will be excluded from the officer certification requirements under Rules 13a-14 and 15d-14 of the Exchange Act.

The principal changes from the proposing release include:

- Modified treatment of liability for the interactive data files under the federal securities laws only will be available for interactive data files that a filer submits within 24 months of the time the filer first is required to submit interactive data files and no later than October 31, 2014.
- The phase-in schedule has been changed from the proposal. The filers that will be phased in during year one will first be required to submit an interactive data file for a periodic report on Form 10-Q, Form 20-F or Form 40-F containing financial statements for a fiscal period ended on or after June 15, 2009. Filers that are phased in during years two and three will be treated in a similar manner. Filers that first become subject to the requirement to submit interactive data after year three will first

[84] Although the interactive data formatted version of the financial statements will be provided in a separate exhibit and subject to modified liability during the specified period, the financial statements themselves will, of course, continue to be part of the registration statement or report and therefore subject to the full panoply of the federal securities laws, including, without limitation, Sections 11, 12(a)(2) and 17 of the Securities Act and Sections 10(b), 13 and 18 of the Exchange Act.

be required to submit an interactive data file for a quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F, as applicable.

- The amendments will require that interactive data be submitted with a Securities Act registration statement filing only after a price or price range has been determined and any later time when the financial statements are changed, rather than requiring interactive data submissions with each filing.
- The amendments will require companies to submit interactive data for financial statements contained in additional forms - Securities Act registration statements on Forms F-9 and F-10 and periodic reports on Forms 40-F[85] as well as reports on Forms 8-K and Form 6-K that contain revised or updated financial statements.[86]
- The timing of the required Web site posting has been eased. A filer must post the interactive data exhibit on its corporate Web site not later than the end of the calendar day it submitted or was required to submit the interactive data exhibit, whichever is earlier. As proposed, Web site posting would have been required by the end of the business rather than calendar day.
- Interactive data will be required to be posted for at least 12 months on an issuer's

[85] Similar to Form 20-F, Form 40-F may be used either as a periodic report or a registration statement under the Exchange Act. As adopted, the amendments will require interactive data for Form 40-F only when used as a periodic report.

[86] See note 74 above.

Web site. The proposing release did not specify this, but commenters requested clarification.

- While the amendments will require filers to tag separately each amount within a footnote or schedule (i.e., monetary value, percentage, and number), the rules will permit, but not require, filers to tag, to the extent they choose, each narrative disclosure.

We intend to monitor implementation and, if necessary, make appropriate adjustments to the adopted amendments.

II. DISCUSSION OF AMENDMENTS

A. Submission of Financial Information Using Interactive Data

For several years XBRL U.S. and its related entities, in consultation with the Commission staff and FASB staff, have developed and refined the list of tags to classify and define financial information in accordance with U.S. financial reporting practices and Commission regulations.[87] Many investors, accountants, and others, including companies that have been providing interactive data disclosure in the voluntary program, have helped in this process.

Interactive data financial statements using the list of tags for U.S. financial statement reporting have been submitted voluntarily to us by over 100 companies, some of which have done so since the start of the voluntary program. The list of tags for U.S. financial statement

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[87] Press Release No. 2006-158 (Sept. 25, 2006).

reporting has expanded significantly since the original version available for the voluntary program.[88] During this period, there has been a continuous increase in both the number and capabilities of software products and applications for users of interactive data, as well as of the services to assist companies to tag their financial statements using interactive data.[89] The growing number of software applications available to preparers and consumers is helping make interactive data increasingly useful to both institutional and retail investors, as well as to other participants in the U.S. and global capital markets. On this basis, we believe interactive data, and in particular the XBRL standard, is growing and that the updated list of tags for U.S. financial statement reporting is now sufficiently comprehensive to require that U.S. GAAP-reporting companies provide their financial statements in interactive data format using XBRL.[90] We anticipate that there will be a further update of this list of tags in February 2009 but that the newer tags will not differ significantly from the old list and that any update would not pose an additional burden to the tagging process.

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[88] When we adopted the voluntary program, the list of tags for U.S. GAAP financial statement reporting contained approximately 4,000 data elements. The list of tags released on April 28, 2008 contains approximately 13,000 data elements, with the most significant additions relating to the development of elements for standard U.S. GAAP footnote disclosure.

[89] Press Release No. 2007-253 (Dec. 5, 2007).

[90] As previously noted, however, the new rules will not apply to investment companies registered under the Investment Company Act and other entities.

With respect to the list of tags for IFRS financial reporting, the IASCF has, over several years, developed a list of tags designed to classify and define financial information in accordance with international accounting standards as issued by the IASB. Over the course of the past year, the IASCF has worked to strengthen the development of its list of tags by forming an XBRL Advisory Committee and an XBRL Quality Reporting Team, both consisting of international representatives from investors, auditors, accountants, regulators and others. On March 31, 2008, the IASCF published a near final version of the list of tags for IFRS financial reporting,[91] which was subject to public comment through May 30, 2008.[92] On June 24, 2008, the IASCF published the final version.[93] In addition, the IASCF is collaborating with XBRL U.S., other foreign regulators, accounting industry members, analyst/investor groups, XBRL technology/software service providers, and others to align practices designed to improve and broaden the IFRS list of tags. This collaboration involves the development of the appropriate scope for the IFRS list of tags' content and technology architecture. On this basis, we believe that the updated IFRS list of tags will be sufficiently advanced to require that foreign private issuers that prepare their

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[91] Unless stated otherwise, when we refer to the "list of tags for IFRS financial reporting" we mean the interactive data taxonomy that is based on IFRS as issued by the IASB.

[92] See Press Release, The IASC Foundation publishes IFRS Taxonomy 2008 (March 31, 2008), available at http://www.iasb.org/News/Press+Releases/The+IASC+Foundation+publishes+IFRS+Taxonomy+2008.htm.

[93] See Press Release, The IASC Foundation publishes IFRS Taxonomy 2008 (June 24, 2008), available at http://www.iasb.org/News/Press+Releases/IASC+Foundation+publishes+IFRS+Taxonomy+2008.htm.

financial statements in accordance with IFRS as issued by the IASB provide their financial statements in interactive data format under the phase-in schedule we are adopting.

As discussed in more detail below, the new rules set forth a phase-in period that begins with domestic and foreign large accelerated U.S. GAAP filers with a worldwide public common equity float above $5 billion as of the end of the second fiscal quarter of their most recently completed fiscal year. These large accelerated filers will be subject to the new rules beginning with their first quarterly report on Form 10-Q, or annual report on Form 20-F or Form 40-F, that contains financial statements for fiscal periods ending on or after June 15, 2009. Although it will not be required, we encourage other U.S. GAAP filers to provide financial information in interactive data format during the phase-in period. In such an instance, these filers' voluntary interactive data submissions will be under the rules as adopted instead of the existing rules of the voluntary program. We also encourage foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB to provide financial information in interactive data format once EDGAR will accept such filings.[94] Prior to this time, such foreign private issuers will be unable to submit financial information in interactive data format.

The new rules will require filers to provide the same type of information in interactive data format that companies have been providing in the voluntary program,[95] together with the

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[94] Pursuant to the EDGAR Filer Manual, we will notify filers of the ability to file in IFRS on our Web site.

[95] Unlike the voluntary program, unless otherwise stated, an interactive data file will be required to be provided with the traditional format filing to which it relates. Companies will not be permitted to provide an interactive data

following items: the footnotes to the financial statements; any applicable schedules to the financial statements; and document and entity identifier tags, such as company name and public float. As is the case in the voluntary program, the new requirement for interactive data reporting is intended to be disclosure neutral in that we do not intend the rules to result in companies providing more, less, or different disclosure for a given disclosure item depending upon the format whether ASCII, HTML, or XBRL.

Because we believe that the various electronic formats have uses for which each is best suited, we will continue to require the existing ASCII and HTML electronic formats now used in filings.[96] We also believe it is necessary to monitor the usefulness of interactive data reporting to investors and the cost and ease of providing interactive data before we consider discontinuing the use of ASCII and HTML formats and the integration of formats. However, the new rules will treat interactive data as part of the official filing, instead of as only a supplement as is the case in the voluntary program.[97] Further evaluation also will be useful with respect to the availability of inexpensive and sophisticated interactive data viewers. In fact, there are many software providers and financial printers that are developing interactive data viewers. We anticipate that

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file with a Form 8-K or 6-K unless it presents in interactive data format the revised or updated financial statements included in that Form 8-K or 6-K as described in footnote 74. See Part II.B.4 for a further discussion.

[96] For example, HTML currently is best suited for providing human-readable text.

[97] As further discussed below in Part II.C.3, however, interactive data generally will be deemed not filed for purposes of specified liability provisions.

these will become widely available and increasingly useful to investors.

We expect that the open standard feature of the XBRL format will facilitate the development of applications and software, and that some of these applications may be made available to the public for free or at a relatively low cost. The expected continued improvement in this software should give the public increasingly useful ways to view and analyze company financial information. As we continue to evaluate the use of the new interactive data technologies, software, and lists of tags, we may consider proposing rules to require a filing format that integrates HTML with XBRL or eliminate financial statement reporting in ASCII or HTML format.

We believe XBRL is the appropriate interactive data format with which to supplement ASCII and HTML. Our experience with the voluntary program and feedback from company, accounting, and software communities point to XBRL as the appropriate open standard for the purposes of this rule. XBRL data will be compatible with a wide range of open source and proprietary XBRL software applications. As discussed above, many XBRL-related products exist for analysts, investors, public and private companies, and others to create and compare financial data more easily; still others are in development, and that process will likely be hastened by increased public company reporting using interactive data.

Most commenters generally supported the required submission of interactive data,[98] but a significant number did not.[99] Some commenters that supported the required submission of interactive data believed it would improve the usefulness of financial information to companies and investors, and that mandated interactive data use would provide the incentives to drive sufficient investment in software to enable widespread adoption of interactive data.[100] Commenters that provide interactive data services stated that issuers would need to expend only modest cost and effort to comply with the proposed requirements.[101] One commenter stated that it expected that costs would fall quickly, especially for small companies, as interactive data became part of standard corporate accounting software packages.[102] Another commenter stated that, based on its experience in the voluntary program, costs would fall significantly for

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[98] See, e.g., letters from American Bar Association (ABA), American Institute of Certified Public Accountants (AICPA), Astoria Financial Corp. (Astoria), California Public Employees' Retirement System (CalPERS), EDGAR Online, Inc. (EDGAR Online), and Financial Executives International (FEI).

[99] See, e.g., letters from Council of Institutional Investors (CII), Financial Services Information Division of the Software and Information Industry Association (FISD), EuropeanIssuers, Committee of Annuity Insurers (COAI), Valero Energy Corp. (VEC), and Wellpoint, Inc. (WellPoint).

[100] See, e.g., letters from American Business Conference (ABC), AICPA, National City Corporation (National City), New York State Society of Certified Public Accountants (NYSSCPA), and United Technologies Corporation (UTC).

[101] See, e.g., letters from Enterprise Compliance International (ECI), EdgarFilings, and UBMatrix, Inc..

[102] See letter from James Angel, PhD (Angel).

subsequent submissions.[103] One commenter stated that it expected that preparing financial information in interactive data format would result in less manual effort and provide the foundation to improve business processes.[104] Similarly, comments on our 2004 concept release and proposed rules in 2004 and 2007 generally supported interactive data and XBRL in particular.[105]

Many commenters objected to some or all of the requirements as proposed and suggested alternatives.[106] For instance, one commenter argued that implementing interactive data would add significant costs to purchase software, and pay for assistance and annual maintenance fees for that software.[107] This commenter believed that the costs of using interactive data outweighed the benefits. Several commenters also claimed that complying with the proposed requirements

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[103] See letter from PepsiCo., Inc..

[104] See letter from UTC.

[105] Release No. 33-8497 (Sept. 27, 2004) [69 FR 59111] (concept release); Release No. 33-8496 (Oct. 1, 2004) [69 FR 59098]; Release No. 33-8781 (Feb. 12, 2007) [72 FR 6676]. See, e.g., letter from Deloitte regarding the voluntary program proposing release and letter from PR Newswire Association LLC regarding the concept release. We also note that participants in the voluntary program provided positive feedback with respect to possible required use of XBRL. For example, the vast majority of voluntary program participants that submitted responses and views to a questionnaire answered in the affirmative to the question "Based on your experience to date, do you think it would be advisable for the Commission to continue to explore the feasibility and desirability of the use of interactive data on a more widespread and, possibly, mandated basis?" See question V.f in the Interactive Data Voluntary Program Questionnaire available at http://www.sec.gov/cgi-bin/XBRL_Questionnaire.

[106] See, e.g., letters from ABA, ACLI/AIA, AllState, Astoria, CSG, FEI, FirstEnergy, IBM, Intel, National City, Pfizer and SCS.

[107] See, e.g., letter from Florida Power and Light Company (FPL).

would not reduce the likelihood of human error or would not reduce costs for issuers.[108] In this regard, one commenter stated that the additional costs would make the U.S. market less attractive to foreign issuers.[109]

Some commenters that objected to the required submission of interactive data believed that interactive data would not at this point improve the usefulness of financial information to analysts or investors.[110] Some of these commenters suggested that there was not a widespread demand for interactive data in the market, and that the Commission should allow market forces to provide incentives for more widespread voluntary implementation of interactive data.[111] Other commenters believed that before adopting this requirement a way needs to be developed to independently verify that financial data have been tagged accurately and ensure that information that is consistent with that in the traditional format filing is provided to investors.[112]

Although commenters generally favored XBRL as the most appropriate interactive data format, some commenters expressed concerns about XBRL itself or the manner in which it is proposed to be implemented in connection with the proposals. These concerns ranged from the

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[108] See, e.g., letters from CSG, EEC, National City, Southern and VEC.

[109] See letter from EuropeanIssuers.

[110] See, e.g., letters from BDO Seidman, LLP (BDO), CII, EuropeanIssuers, and VEC.

[111] See, e.g., letters from EuropeanIssuers and Jay Starkman (Starkman).

[112] See, e.g., CII and VEC.

availability of adequate software products[113] to the potential that customized taxonomy extensions could grow so common that they would directly interfere with the comparability of inter-company data.[114] A significant number of commenters suggested ways to facilitate interactive data tagging, including exposing for comment the Commission's maintenance and support agreement for XBRL,[115] as well as monitoring,[116] cataloging,[117] providing guidance on[118] and discouraging[119] extension use. We acknowledge these concerns and suggestions and believe that the rules as adopted will address many of them. Widespread, mandatory adoption is expected to foster a network effect and encourage development of cost reducing and improved analytical products. Additionally, we believe that the taxonomy will become even more comprehensive over time as common extensions are incorporated into the base in annual releases thus minimizing any interference that common extensions might have with data comparability.

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[113] See, e.g., letter from Robert Gilmore (Gilmore).

[114] See, e.g., letter from EuropeanIssuers.

[115] See, e.g., letters from Center for Audit Quality (CAQ), Deloitte Touche LLP (Deloitte), E&Y, and PricewaterhouseCoopers LLP (PWC).

[116] See, e.g., letter from CFA.

[117] See, e.g., letter from ABA.

[118] See, e.g. letters from CFA Institute Centre for Financial Market Integrity (CFA), ConstellationEnergy (Constellation), Deloitte, FEI, Grant Thornton, Morgan Stanley, and Rivet Software Inc (Rivet).

[119] See, e.g., letters from Grant Thornton, CFA, Morgan Stanley, and Rivet.

B. Phase-in under the New Rules

1. Overview

The new rules initially will require interactive data reporting only by domestic and foreign large accelerated filers that prepare their financial statements in accordance with U.S. GAAP and have a worldwide public common equity float above $5 billion as of the end of the second fiscal quarter of their most recently completed fiscal year.[120] The first required submissions for issuers that file on domestic forms will be for quarterly reports containing financial statements for a fiscal period ending on or after June 15, 2009. For calendar year companies, this requirement will first apply to their June 30, 2009 quarterly reports filed on Form 10-Q.[121]

Filers under the new rules will be required to submit their financial statements in an interactive data file using the list of tags for U.S. GAAP or IFRS as issued by the IASB, in either case as approved for use by the Commission. The submission also will be required to include any supporting files as prescribed by the EDGAR Filer Manual. Interactive data will be required for the entirety of their financial statements, although tagging of the footnotes and schedules at a

[120] Approximately 500 companies initially will be required to submit interactive data. Other companies, however, initially will be permitted to submit interactive data if they use U.S. GAAP or IFRS as issued by the IASB.

[121] For most U.S. companies and foreign private issuers filing on domestic forms, the periodic report to which this will first apply will be the June 30, 2009 quarterly report. For a company that files on domestic forms with a June 30 fiscal year, the first report will be the September 30, 2009 quarterly report. Foreign private issuers not using domestic forms that are in the first phase-in group will first provide interactive data in connection with their first Form 20-F or Form 40-F annual reports for the year ended on or after June 15, 2009.

deeper level of detail will be phased in the following year.

We did not propose, and are not adopting, a requirement that filers provide interactive data for their Management's Discussion and Analysis (MD&A), executive compensation, or other financial, statistical or narrative disclosure.[122] Many commenters supported this position.[123] Some commenters supported the idea of eventually tagging non-financial statement information because of its usefulness to investors,[124] while others expressed concern that variations among companies in executive compensation practices may not lend themselves to the development of standard tags[125] and should at the most be voluntary rather than required.[126] Another commenter supported the application of interactive data format to MD&A because of a belief that interactive data format for MD&A disclosures would be more useful to investors than detailed tagging of the footnotes to the financial statements.[127] This commenter recommended block tagging each section of the MD&A, with some level of detailed tagging for the numbers and tables. In deciding not to require the tagging of this information at this time, we agree with

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[122] Tagging this information is neither required nor permitted under the amendments.

[123] See, e.g., letters from ABA, General Mills (Gen. Mills), KPMG, Pfizer, Inc. (Pfizer) and The Society of Corporate Secretaries, and Governance Professionals (SCS).

[124] See, e.g., letter from CalPERS.

[125] See, e.g., letters from ABA, Johnson & Johnson (J&J), Pfizer, Gen. Mills, and SCS.

[126] See, e.g., letter from UTC.

[127] See, e.g., letter from National City.

the commenters who believed that more experience with interactive data and a greater understanding of the costs and time associated with compliance with the requirements as proposed is needed before expanding the requirement to other information. We will continue to consider, however, the advisability of permissible optional or required interactive data for disclosures made outside a set of financial statements prepared in accordance with U.S. GAAP or IFRS as issued by the IASB or related financial statement schedules required under Commission rules.

The following tables identify the reports for which a filer would first be required to include interactive data for the company's financial statements according to the company's filing status.[128]

[128] Transition reports that contain financial statements of the type and for the periods specified also will be required to be submitted in interactive data format under the new rules. These dates apply to the initial required interactive data disclosure; detailed tagging of the financial statement footnotes and schedules will not be required for an additional year.

Domestic and Foreign Large Accelerated Filers Using U.S. GAAP with Worldwide Public Common Equity Float above $5 Billion as of the End of the Second Fiscal Quarter of Their Most Recently Completed Fiscal Year	Quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2009.
All Other Large Accelerated Filers Using U.S. GAAP	Quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2010.
All Remaining Filers Using U.S. GAAP	Quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2011.
Foreign Private Issuers with Financial Statements Prepared in Accordance with IFRS as Issued By the IASB	Annual reports on Form 20-F or Form 40-F for fiscal periods ending on or after June 15, 2011.

2. Companies Covered by New Rules and Phase-in

The new rules will cover all companies that report either in U.S. GAAP, including smaller reporting companies and foreign private issuers that report in U.S. GAAP or, in the case of foreign private issuers, in accordance with IFRS as issued by the IASB.[129] On November 14, 2008, we issued a release proposing to allow certain domestic issuers to prepare financial statements in accordance with IFRS as issued by IASB.[130] The phase-in will require domestic and foreign large accelerated filers that report in U.S. GAAP and meet the minimum worldwide common equity float of greater than $5 billion to provide their initial interactive data submissions in year one of the phase-in period discussed above. All other U.S. GAAP filers that meet the definition of large accelerated filer will be required to provide their initial interactive data submissions in year two of the phase-in period. All remaining U.S. GAAP filers, including smaller reporting companies and companies not previously subject to periodic reporting requirements, will be required to provide their initial interactive data submissions in year three of the phase-in period.

Foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB will be required to provide their initial interactive data submissions in year

[129] As noted above, however, the new rules would not apply to investment companies registered under the Investment Company Act, business development companies, or other entities that report under the Exchange Act and prepare their financial statements in accordance Article 6 of Regulation S-X.

[130] See Release No. 33-8982 (Nov.14, 2008) [73 FR 70816].

three of the phase-in period.

The additional phase-in time for all but the largest accelerated filers is intended to permit companies to plan and implement their data tagging with the benefit of the experience of year one filers. It also is intended to enable us to monitor implementation and, if necessary, make appropriate adjustments during the phase-in period. With respect to foreign private issuers that report using IFRS as issued by the IASB, the additional phase-in time for these issuers is to allow greater development of the IFRS list of tags and our ability to accept filings using them.

Our multiyear experience with the voluntary program has helped us to better understand the extent to which a filer will incur additional costs to create and submit its existing financial disclosures in interactive data format. Based on that experience, we believe that the process of preparing an interactive data file will not impose a significant burden or cost. The voluntary program clearly demonstrated, although that program was limited to face financial statements only and not footnotes, that companies can, if they choose, tag their financial statements using currently available software without need of outside services or consultants; alternatively, they can rely on financial printers, consultants, and software companies for assistance, although they will retain ultimate responsibility for both their financial statements and their tagged data. As discussed in more detail in the cost-benefit analysis below,[131] we believe that first-year costs for a company will decrease in subsequent periods, particularly after detailed footnote tagging has

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[131] See Part V.

been implemented. We also believe that these costs will be justified by interactive data's benefits. As with domestic registrants, we believe foreign private issuers that report in U.S. GAAP or prepare their financial statements in accordance with IFRS as issued by the IASB will be able to comply with the rules without incurring significant costs.

We expect that smaller companies, which generally are disproportionately affected by regulatory costs, also will be able to provide their reports in interactive data format without undue effort or expense. While interactive data reporting involves changes in reporting procedures, mostly in the initial reporting periods, we expect that these changes may provide efficiencies in future periods. As a result, there may be potential net savings to the filer, particularly if interactive data become integrated into the filer's financial reporting process. While we recognize that requiring interactive data financial reporting will likely result in start-up expenses for smaller companies, these expenses may be lower than those of larger filers, given that smaller filers tend to have simpler financial statements than larger companies, with fewer elements and disclosures to tag. In addition, we expect that both software and third-party services will be available to help meet the needs of smaller filers. We expect that the phase-in will foster the improvement and availability of inexpensive software and that a firmly established phase-in deadline could stimulate the development of such software. We also intend that the third year phase-in for smaller reporting companies will permit them to learn from the experience of the earlier filers. It will also give them a longer period of time over which to spread first-year data tagging costs.

As noted above,[132] CIFiR issued its final report recommending that the Commission, over the long term, phase in the requirement that companies file financial statements using interactive data after the satisfaction of specified preconditions:

- successful testing of the list of tags for U.S. financial statement reporting;
- the ability of reporting companies to file interactive data on the Commission's electronic filing system using the new list of tags for U.S. financial statement reporting; and
- the ability of the Commission's electronic filing system to provide an accurate human-readable version of the interactive data.

CIFiR recommended that we phase in financial statements using interactive data by requiring the largest 500 domestic registrants,[133] as determined by the value of shares held by unaffiliated persons, to furnish (rather than file) interactive data for the face of their financial

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[132] See Part I.C above.

[133] The recommendation does not address foreign companies. We do not believe that whether a U.S. GAAP reporting company is domestic or foreign should determine the applicability of the rules, and therefore foreign companies using U.S. GAAP will be included in the phase-in schedule along with their domestic counterparts. As noted, foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB also will be subject to the interactive data submission requirements, although they would not be phased in until year three. We also note that the CIFiR Final Report does not expressly address filings other than Exchange Act periodic reports.

statements and, in block-tagged form,[134] the footnotes to the financial statements. The Final Report also recommends that, one year after we impose this requirement on the first group of registrants, we impose the same requirement on the remaining domestic registrants that fall within the definition of "large accelerated filer." Finally, the Final Report recommends that, once the specified conditions have been satisfied and the second phase-in period has been implemented, we evaluate whether and when to require that the domestic large accelerated filers file rather than furnish financial statements in interactive data format, as well as the inclusion of all other reporting companies.

Several commenters suggested a later phase-in for all companies with start dates of the second half of 2009 and when these pre-conditions are met. These commenters generally reasoned that the additional time would help companies and service providers to prepare.[135]

We believe that sufficient progress has been made regarding each of CIFiR's preconditions, particularly with respect to the list of tags for U.S. financial statement reporting.[136] While admittedly there has been only limited experience with footnote tagging, the current list of tags for U.S. financial statement reporting has been in wide use by participants in

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[134] "Block" text means that the entire footnote or other discrete item, such as a schedule or table, would be tagged as an individual element.

[135] See, e.g., letters from National City, Safeway, Inc. (Safeway), and Emerson Electric Company (EEC).

[136] We are still working on the ability to use the IFRS list of tags with our system, but expect it to be operational by the time filers that report in accordance with IFRS are required to submit interactive data files. As will be provided in the EDGAR Filer Manual, we will publish on our Web site when EDGAR can support filings that use the IFRS list of tags.

the voluntary program in submissions to us.[137] We understand that the list also is being used by companies that are tagging their financial statements outside of the voluntary program, including experimenting with footnote tagging. The tags also will be updated in an expected January 2009 version. The updated list is expected to contain improvements such as the reflection of new accounting pronouncements. The Commission's IDEA system into which companies actually will submit interactive data has been effectively implemented and the ability of companies to do so is now established. Finally, the Commission has developed a viewer to provide an accurate human-readable version of interactive data. Both the filing and viewing capabilities are fundamentally enhanced versions of applications and processes that were already in place for the voluntary program.

We have also carefully considered the Committee's thoughtful recommendation, including the recommended phase-in of 500 initial companies and delayed consideration of non-accelerated and other filers until after two years. We are adopting a phase-in schedule similar to that suggested by the Committee.[138] However, instead of waiting until after the second year to determine whether to propose extending the applicability of the rules to all filers, the new rules will establish a phase-in for the remaining companies' required interactive data submissions

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[137] Since June, when it became available on EDGAR, approximately 60 companies have completed approximately 100 submissions using the new taxonomy.

[138] As previously noted, the worldwide public float cutoff of $5 billion will result in approximately 500 companies subject to the new rules in year one.

that will begin in the third year. Based on comments received on the proposing release, participants' experience with the voluntary program and our consultations with filers, software providers and filing intermediaries, we believe the new rules will accelerate the improvement and availability of inexpensive software. This, in turn, should generate more options and assistance for non-accelerated filers in general and, in particular, smaller reporting companies and foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB in particular so that they could become proficient in the use of interactive data without undue burden.

One commenter expressed concern about whether the initial phase-in of 500 issuers would involve enough companies to create a "network effect" so users of financial reporting obtain the benefits of interactive data in peer comparisons that are most useful and likely to occur if many or all filers provide financial reporting using interactive data.[139] Although including a larger number of filers in the initial phase-in might increase the overall commercial and analytical value of the interactive data, which in turn would likely increase the supply of software for analyzing and presenting interactive data to analysts and investors, we believe a firm schedule for all U.S. GAAP and IFRS reporting companies to file their financial statements using interactive data can provide an incentive to stimulate the further development of interactive data-related software and services, while also affording most companies additional time to learn from the experience of others.

We also believe that concurrently adopting a phase-in for non-accelerated filers in general and, in particular, smaller reporting companies, and foreign private issuers using IFRS as issued by the IASB will establish an appropriate and measured timeline, which we will be able to monitor and, if necessary, reconsider during the first two years of the phase-in.

Commenters generally supported the proposed phase-in schedule. A substantial majority of the commenters, however, suggested that the initial submission required be a Form 10-Q for

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[139] See letter from CalPERS.

domestic companies.[140] Other commenters recommended that the phase-in commence with filings made for fiscal periods[141] or years[142] beginning on or after December 15, 2008 or fiscal years beginning after December 31, 2008,[143] as opposed to fiscal periods ending on or after December 15, 2008, as proposed. The reasons cited by commenters included assuring that issuers would submit an interactive data file for three Forms 10-Q before submitting it for a Form 10-K,[144] providing more time for issuers and service providers to prepare[145] and allowing bugs to be detected in quarterly filings before the more widely distributed annual filings.[146]

The commenters suggesting that the initial submission required be a Form 10-Q for domestic issuers generally reasoned that it would be helpful to companies and service providers alike if they could begin with a relatively simple form. Many of these commenters suggested that the content requirements of quarterly reports would be less burdensome than those of annual reports and allow companies to allocate more staff to initial tagging and provide a tagged

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140 See, e.g., letters from ABA, American Council of Life Insurers/American Insurance Association (ACLI/AIA), AICPA, AllState Corp. (AllState), Credit Suisse Group (CSG), and Comcast Corp. (Comcast).

141 See, e.g., letter from Constellation.

142 See, e.g., letters from Comcast, Grant Thornton, and Pfizer.

143 See, e.g., letter from Astoria.

144 See, e.g., letters from Astoria and Comcast.

145 See, e.g., letter from Constellation.

146 See, e.g., letter from Grant Thornton.

template on which to build for subsequent filings.[147] At least one commenter acknowledged, however, that despite the greater initial effort posed by tagging an annual report, the comprehensiveness of this report would cause companies to address most of the issues in quarterly reports.[148] Some service providers commented that although a complete annual report is more effort for preparers, creating a related XBRL document is about the same level of effort for both a Form 10-K and Form 10-Q (assuming the footnotes are block tagged) and that the biggest difference between the forms is the larger number of footnotes in a Form 10-K, resulting in a nominal number of additional hours of effort.[149] These commenters further stated that allowing the tagging of a Form 10-Q instead of a Form 10-K would delay the use and development of XBRL by issuers while providing no significant savings of time or money. Overall, the commenters that generally supported the proposed phase-in schedule took the view that companies and service providers would be ready and the date certain together with the significant number of issuers involved would encourage potential vendors of interactive data products and services to invest in the development and marketing of new and improved products and services.[150]

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[147] See, e.g., letters from EEI, IBM, Pfizer, Southern Company (Southern), United States Steel Corporation (USS) and UTC.

[148] See letter from Association of the Bar of the City of New York (NYCBA).

[149] See, e.g., letters from EDGAROnline and Rivet.

[150] See, e.g., letters from PepsiCo., EDGAROnline and Rivet.

Many of the commenters that suggested that the phase-in be slower had concerns related to the potential costs and burden of detailed footnote tagging.[151] Some commenters suggesting a different initial phase-in period than what was proposed cited the ability to assess costs and technology advancements.[152] Commenters also were concerned that such detailed tagging could result in more company specific extensions than anticipated, which might not be comparable between companies and present information out of context.[153]

One commenter suggested that the phase-in should be faster for some filers, and specifically recommended that all large accelerated filers reporting in accordance with U.S. GAAP be made subject to the filing requirements in the first year, perhaps starting with a quarterly report.[154] Other commenters stated that not only is tagging relatively simple and inexpensive, but that we should endeavor to get more companies tagging sooner in order to enhance the value of information available and to provide further impetus for software development.[155]

Some commenters also suggested that the rules should exclude or defer foreign private

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[151] See, e.g., letters from ABA, Constellation, SCS and Intel. See Part .II.B.3.a below for a more detailed discussion of footnote tagging.

[152] See, e.g., letters from EEI, Cisco Systems (Cisco), Comcast, and PPG Industries Inc. (PPG).

[153] See, e.g., the letters from ABA, ACLI/AIA, CSG. FEI, IBM and Intel.

[154] See letter from Grant Thornton.

[155] See, e.g., letters from UBMatrix, EDGAROnline.

issuers because of the possibility that there might be a disproportionate burden on these issuers.[156] As to foreign private issuers reporting in accordance with U.S. GAAP and who meet the criteria for the first phase-in period in particular, several commenters stated that these issuers could face extra burdens potentially due to less access to service provider help, language barriers, a need to address both the U.S. GAAP list of tags and, possibly, relatively soon after, the IFRS IASB list of tags (such as those issuers that have signaled an intention to report in accordance with IFRS as issued by the IASB and discontinue reporting in U.S. GAAP), and have a potential competitive disadvantage in comparison to foreign private issuers already reporting in accordance with IFRS as issued by the IASB who would not have to tag until the third year.[157] One commenter suggested treating all foreign private issuers the same and placing them on the later phase-in schedule (or at least the ones that have announced an intention to switch to IFRS as their sole reporting standard).[158]

One commenter expressed the desire that the phase-in not be delayed due to a possible conversion away from U.S. GAAP to IFRS. The commenter noted in this regard that it believed interactive data could facilitate such a conversion if similar items were to receive similar tags.[159]

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[156] See, e.g., letters from CSG, Nippon Keidanren (NK), Philips International B.V. (Philips) and Sullivan & Cromwell (S&C).

[157] See, e.g., letters from Credit Suisse Group (CSG), NK, Philips, S&C, and J.P Morgan (JPM).

[158] See letter from Philips.

[159] See letter from CFA.

In light of the differing opinions among commenters, the experience of those in the voluntary program, the size and resources of those issuers in the first group, and our ability to monitor the experiences of those larger first phase companies, we believe that the phase-in period as modified from the proposal generally addresses the burden and expense concerns expressed by some commenters. In this regard, as noted above, a filer first will be required to submit an interactive data file for a Form 10-Q, Form 20-F or Form 40-F, as applicable and the phase-in period will begin later than proposed. We believe that this approach will provide issuers more time to prepare their financial statements and service providers more time to deliver adequate software to support them. The staff also will consider requests to defer the phase-in on a case-by-case basis for issuers with special circumstances, particularly where the filer is committed to switching its basis of reporting to IFRS as issued by the IASB. Issuers could make such requests by applying for a continuing hardship exemption under amended Rule 202 of Regulation S-T.[160]

With respect to Canadian issuers, one commenter stated that such issuers filing forms under the Multijurisdictional Disclosure System (MJDS)[161] should be able to submit interactive

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[160] As further discussed in Part II.E, Rule 202 will permit an issuer to apply in writing for a continuing hardship exemption from the requirement to provide interactive data if the issuer cannot do so without undue burden or expense.

[161] Certain Canadian foreign private issuers file registration statements and annual reports under the MJDS, which permits eligible Canadian companies to use their disclosure documents prepared in accordance with Canadian requirements in filings with the Commission.

data regardless of whether reporting in U.S. GAAP in order to avoid placing such issuers at a competitive disadvantage to other issuers permitted or required to submit interactive data.[162] The commenter stated that if it would not be feasible to enable such issuers to submit interactive data using a Canadian GAAP taxonomy, then the Commission should permit such issuers to tag a U.S. GAAP reconciliation. Consistent with the commenter's concern and our solicitation of comment in the proposing release, we are adding MJDS Forms F-9, F-10 and 40-F to the forms we expressly proposed to be subject to the interactive data requirements in adopting the requirements. The rules will not, however, require or permit interactive data related to these MJDS forms to be submitted when the financial statements they contain are prepared in accordance with Canadian GAAP or as a U.S. GAAP reconciliation. There is no taxonomy for Canadian GAAP or a U.S. GAAP reconciliation and, as a result, there is not sufficient tagging guidance to produce tags that would be comparable across companies using Canadian GAAP.

As proposed and as adopted, investment companies registered under the Investment Company Act, business development companies or other entities that report under the Exchange Act and prepare their financial statements in accordance with Article 6 of Regulation S-X will not be subject to the new rules. The one commenter to address the exclusion of these companies agreed with this approach and stated that the investment management financial reporting taxonomy is not sufficiently developed and that the degree of investor benefit from tagging that

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[162] See letter from Canadian Pacific Railway (CP).

occurs in the case of other types of issuers is not present for investment company and similar issuers.[163]

3. Information and Documents Covered by the New Rules

a. Financial Statements, Footnotes, and Financial Statement Schedules

The rules will require interactive data tagging of a filer's complete financial statements and any required financial statement schedules.[164] As with the voluntary program, the new rules will require companies to provide the interactive data in an exhibit. Interactive data will be required for all periods included in the filer's financial statements.[165] As proposed and as adopted, the new rules will not, however, require interactive data submissions for other financial statements that may be required of filers, including those provided pursuant to Rules 3-05, 3-09, 3-14, and 3-16 of Regulation S-X.[166] This approach was generally supported by commenters.[167]

As with the voluntary program, the new rules will require that the line item descriptions

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[163] See letter from the Investment Company Institute.

[164] As previously noted, new Rule 405 of Regulation S-T will directly set forth the basic tagging requirements and indirectly set forth the rest of the tagging requirements through the requirement to comply with the EDGAR Filer Manual. Consistent with new Rule 405, the EDGAR Filer Manual will contain the detailed tagging requirements.

[165] References in the rules to the financial statements of the filer or issuer also include financial statements of its predecessor to the extent they are included in the related registration statement or report pursuant to Rule 3-02 of Regulation S-X, Instruction 1 to Item 8 of Form 20-F or the requirements applicable to Forms F-9, F-10 or 40-F.

[166] 17 CFR 210.3-05, 17 CFR 210.3-09, 17 CFR 210.3-14, and 17 CFR 210.3-16. Additionally, pro forma financial statements prepared under Article 11 of Regulation S-X are not subject to the interactive data requirements.

[167] See, e.g., letter from Deloitte.

and amounts presented on the face of the financial statements in the traditional format filing be the same as in the interactive data format. Also, the rules will prohibit partial presentation of face financial statements in interactive data format. For example, filers will not be permitted to exclude comparative financial information for prior periods.

Unlike the voluntary program, our new rules require companies using U.S. GAAP or foreign private issuers using IFRS as issued by the IASB to provide tagged data for the footnotes and schedules to the financial statements. The 2005 adopting release for the voluntary program stated that we recognized that technical issues made it difficult to tag the notes to the financial statements. We did, however, provide volunteers with the option of tagging the notes to the financial statements.[168] Since the time of the adopting release, the necessary list of tags has been completed and the available software has advanced sufficiently to require that the financial statement footnotes and schedules be included in the new rules.

The voluntary program adopting release recommended that if participants voluntarily provided footnotes in interactive data format, then they should provide enough detail so that the tagging would be of practical value to users. The release stated that a single tag for the entire group of footnotes in a filing would cover too much information to be useful to the user. We still believe that one tag for the entire group of footnotes would be confusing and provide little

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[168] See Part II.E. of Release No. 33-8529 (Feb. 3, 2005) [70 FR 6556].

benefit. If filers tag each footnote separately, however, users will be able to compare footnote disclosure between periods and across filers while minimizing the burden on preparers. We are therefore adopting the requirement that footnotes be tagged using four different levels of detail:

(i) each complete footnote tagged as a single block of text;

(ii) each significant accounting policy within the significant accounting policies footnote tagged as a single block of text;

(iii) each table within each footnote tagged as a separate block of text; and

(iv) within each footnote, each amount (i.e., monetary value, percentage, and number) separately tagged.

To allow filers time to become familiar with tagging footnotes, in each filer's first year of interactive data reporting, only level (i) will be required. All four levels will be required starting one year from the filer's initial required submission in interactive data. In year two, for the first filing required to have detailed tagging of footnotes and schedules, the filer will have an additional 30 days to submit the interactive data exhibit. This is similar to the grace period provided for a filer's first required filing with interactive data. Subsequent interactive data exhibits using all of the levels will be required at the same time as the rest of the related report or registration statement. We believe the 30 day grace period will help a filer comply with the more detailed tagging requirements.

The requirement that in the second year a filer tag separately each amount within a footnote (i.e., monetary value, percentage, and number) should not affect a filer's decisions regarding what to disclose. We are aware of questions as to whether the contextual information or data elements chosen from the standard list of tags could potentially reveal information that the rest of the related registration statement or periodic report would not otherwise make known. However, we do not believe that the contextual information or data elements chosen should provide any additional substantive disclosure.

To clarify the intent of the interactive data requirements, new Rule 405 of Regulation S-T, that sets forth tagging requirements, includes an instruction that states that the rule requires a disclosure format, but does not change substantive disclosure requirements. As proposed and as adopted, the rules also state clearly that the information in interactive data format should not be more or less than the information in the ASCII or HTML part of the related registration statement or report.[169]

As briefly noted above, commenters provided a mix of views on the footnote tagging requirements we proposed. Many commenters objected to some or all of the requirements as proposed and suggested alternatives.[170] In terms of burden, a significant number of commenters objected, in particular, to level (iv) tagging in whole or part.[171] Several of these commenters argued that detailed footnote tagging would require significant effort from the issuer and could be confusing because of the high number of company-specific extensions and the risk of

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[169] See Preliminary Note 2 of Rule 405 of Regulation S-T.

[170] See, e.g., letters from ABA, ACLI/AIA, AllState, Astoria, FEI, FirstEnergy, IBM, Intel, National City, and SCS.

[171] See, e.g., letters from ABA, ACLI/AIA, AllState, Astoria, CSG, FEI, FirstEnergy, IBM, Intel, National City, Pfizer, and SCS.

inconsistency among filers due to varying footnote formats.[172] Other criticisms included assertions that the effort required would be greater than the Commission estimated,[173] overly burdensome[174] and duplicative,[175] would result in so many extensions that the information would not be comparable among issuers,[176] and would produce information that users inappropriately would take out of context.[177]

Other commenters reacted more favorably, with some suggesting alternatives to the proposed rules. For instance, a number of commenters recommended that the detailed tagging of footnotes be gradually phased in to provide more time for issuers to get acclimated to the process and for the development of standard taxonomies.[178] Other commenters suggested that the required detail tagging of footnotes should focus on the most useful and used footnote data rather on a broad array of data that would require issuers to apply thousands of additional tags for detailed financial and narrative information.[179] Similarly, another commenter suggested that

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[172] See, e.g., the letters from ACLI/AIA, FEI, IBM, and Intel.

[173] See, e.g., letter from SCS.

[174] See, e.g., letter from Intel.

[175] See, e.g., letter from FEI.

[176] See, e.g., letter from ABA.

[177] See, e.g., letter from CSG.

[178] See, e.g., letters from Comcast, Constellation, EEI, Ernst & Young LLP (E&Y), Morgan Stanley, National Association of Real Estate Investment Trusts (NAREIT), and Southern.

[179] See, e.g., letters from Intel, Morgan Stanley, and SCS.

detail tagging only be required as to the more standardized types of footnotes.[180]

[180] See letter from USS.

While we are adopting the proposed requirement to tag separately each amount within a footnote (i.e., monetary value, percentage, and number), we will permit, but not require, filers to tag, to the extent they choose, each narrative disclosure. We believe that adopting the footnote tagging requirements substantially as proposed strikes an appropriate balance between satisfying investors' needs and not imposing undue burden on issuers. We believe the block-text tagging required under levels (i) through (iii) will satisfy the needs of those who desire information within the context of an entire footnote or an entire table. We also believe that requiring the detail tagging of individual amounts but permitting the detail tagging of narrative disclosures within the footnotes as provided under level (iv) will satisfy the needs of those who desire to analyze specific pieces of information or data. Further, we believe that by permitting filers to choose whether and which elements to tag in the narrative disclosures of the footnotes and schedules, they are granted a degree of flexibility and relieved of the uncertainty as to which narrative elements to tag, some of which are placed into footnotes and schedules voluntarily. We also believe that not requiring detailed tagging of narratives would not result in the loss of information due to block text tagging. Finally, we believe that taxonomy and software advances, combined with the rules' grace period, will avoid placing an undue burden on issuers. We will, however, monitor the implementation of these amendments and, if necessary, consider making appropriate adjustments to the requirements.

Apart from footnote disclosures, filers may be required under existing financial reporting requirements to include certain supplementary financial statement schedules with their financial statements. The form and content of these schedules are governed by Article 12 of Regulation S-X.[181] The list of tags for U.S. financial statement reporting enables companies to tag individual facts in these financial statement schedules, or to block tag each entire schedule.

Filers also will be required to include with their interactive data any financial statement schedules prescribed by Article 12 of Regulation S-X. These financial statement schedules will be tagged using two different levels of detail; only the first level will be required in the first year. Both levels will be required starting one year from the filer's initial required submission in interactive data format. Similar in concept to the tagging approach adopted for the financial statement footnotes, the required levels of detail will be: (i) each complete financial statement schedule tagged as a block of text; and (ii) each amount (i.e., monetary value, percentage, and number) separately tagged. However, we will permit but not require each narrative disclosure in such schedule to be separately tagged to the extent desired by the filer.

A filer may restate its previously filed financial statements for the correction of an error and file an amendment to its registration statement, periodic report or transition report. Alternatively, a filer may revise its previously filed financial statements to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments, or a change in accounting principle and file a Form 8-K or 6-K or an amendment to a

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[181] See Rules 5-04 and 7-05 of Regulation S-X and Items 17 and 18 of Form 20-F.

pre-effective registration statement. The new rules require a filer to provide revised interactive data at the same time it files the restated or revised traditional format financial statements as an exhibit to the registration statement or report containing those financial statements.[182] If a filer decides to change a tag it used previously that was not inappropriate at the time used, it would not be required to disclose the change.

b. Reports Covered by the New Rules

We are adopting the proposed requirement to submit interactive data for the filer's financial statements contained in periodic reports on Forms 10-Q, 10-K and 20-F and, in addition, extending the requirement to the Form 40-F annual report and to Forms 8-K and 6-K that contain revised or updated financial statements.[183] Under the new rules, filers also will be required to provide interactive data for transition reports on Forms 10-Q, 10-K, or 20-F.

We are extending the interactive data requirements to Form 40-F when used as an annual report because we believe that the effort required to satisfy the requirement and the benefits from doing so would be comparable to the effort and benefits associated with the other periodic reports to which the requirement will apply. In response to our solicitation of comment on

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[182] Revised interactive data will be required so that the financial information will be the same in both the traditional format filing and the interactive data file. If the financial statements are not revised in connection with an amended registration statement, periodic report, or transition report, the exhibit index will indicate that the interactive data file was already provided.

[183] Form 40-F may be filed by a Canadian company filing in accordance with the MJDS. Similar to Form 20-F, it may be used as an annual report or an Exchange Act registration statement.

whether to require interactive data in connection with Forms 40-F, one commenter urged us to at least permit filers to submit interactive data in order to avoid placing filers of that form at a competitive disadvantage.[184]

As discussed above, we are extending the interactive data requirements to Forms 8-K and 6-K that contain updated interim financial statements or financial statements that have been revised to reflect the effects of certain subsequent events. These financial statements typically are not filed as amendments to forms for which we proposed to require interactive data, but they provide timely financial information comparable to that contained in such forms and may be incorporated by reference into registration statements for which interactive data requirements generally apply.[185] In this regard, several commenters noted that registrants use Form 8-K to file financial statements that reflect changes for reasons other than to correct accounting errors.[186]

c. Registration Statements under the Securities Act Covered by the Rules

We are adopting substantially as proposed a requirement that, subject to the phase-in period described above, registration statements filed under the Securities Act,[187] include

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[184] See letter from CP.

[185] Issuers would not be required or permitted to submit an interactive data exhibit to a Form 8-K or 6-K under any circumstances other than those specified. See note 74 above.

[186] See, e.g., letters from Deloitte, E&Y, and KPMG LLP (KPMG).

[187] The requirement will apply to registration statements under the Securities Act on Forms S-1, S-3, S-4, F-9, F-10, S-11, F-1, F-3, and F-4. This includes registration statements for annuity contracts that are filed on Forms S-1 and

interactive data when financial statements are included directly in the registration statement, rather than being incorporated by reference. This requirement will apply to the issuer's financial statements for all periods included in the registration statement as required by Regulation S-X and our other rules. As proposed, the rules would apply from the first filing of a registration statement. The rules as adopted, however, require that interactive data be submitted only after a price or price range has been determined and any time thereafter when the financial statements are changed. We believe analysts, investors, the public, and others will benefit from the enhanced ability of interactive data to locate and compare financial data included in registration statements. Further, under the new rules, interactive data will be required for the acquiring company, the filer, but not for the company being acquired, in the context of a business combination.

Some commenters opposed requiring the submission of interactive data with registration statements for initial public offerings under the Securities Act.[188] Some of these objections included the burdens for newly public companies.[189] However, a number of commenters favored requiring interactive data for initial public offering registration statements, other Securities Act

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S-3. As proposed, however, the requirement that we are adopting will not apply to registration statements on Form N-3, N-4 or N-6, which are used to register variable annuity contracts and variable life insurance policies.

[188] See, e.g., letters from ABC, National City, NYCBA, and Gary Purnhagen (Purnhagen).

[189] See, e.g., letter from ABC.

registration statements or both.[190] Some commenters recommended that interactive data be required to be submitted only after the registration statement becomes effective, given the effort in preparing an initial public offering and the frequency with which initial public offering efforts never come to fruition.[191]

We believe that the interactive data requirements for Securities Act registration statements in general and, in particular, as limited to filings only after a price or price range has been determined and any time thereafter when the financial statements are changed, strike an appropriate balance between the alternatives of requiring interactive data submissions with each pre-effective amendment or waiting until a registration statement has been declared effective. In our experience, most issues related to the staff's review of offerings typically are resolved or near resolution by the time a price range is determined, and, as a result, there typically would be relatively few changes to the financial statements contained in additional amendments. As a result, issuers would be required to tag information that likely is in substantially final form. Consequently, the information would be useful to investors and issuers would be unlikely to need to revise the information significantly in a way that would trigger multiple submissions of interactive data. As each submission would be tagged to indicate that the information in the submission has been revised, we believe investors should be able to monitor changes in the

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[190] See, e.g., letters from AICPA, Grant Thornton, PricewaterhouseCoopers LLP (PWC), CAQ, CalPERS, CFA, UTC, Morgan Stanley, and E&Y.

[191] See, e.g., letters from BDO, CAQ, and PWC.

interactive data efficiently. Further, the rules as adopted provide that a company's first filing to be subject to the interactive data requirement would be a quarterly report or, for a foreign private issuer not required to file quarterly reports, an annual report. Accordingly, interactive data exhibits will not be required for initial public offerings.

d. Registration Statements under the Exchange Act Covered by the Rules

We are not adopting a requirement to submit interactive data for the financial statements contained in registration statements under the Exchange Act on Forms 10, 20-F and 40-F. Although we only expressly proposed to require interactive data in connection with Securities Act registration statements, the proposing release solicited comment on whether to require interactive data for the financial statements in Forms 40-F and in registration statements under the Exchange Act on Forms 10 and 20-F.

One commenter suggested waiting in order to evaluate experience with interactive data submission before requiring submission of Exchange Act registration statements.[192] Another commenter stated that the interactive data requirements should apply to Canadian issuers that report in accordance with U.S. GAAP and, ultimately, IFRS as issued by the IASB.[193] The rules as adopted will not require interactive data files to be submitted as an exhibit to Forms

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[192] See letter from UTC.

[193] See letter from EDGAROnline.

10, 20-F or 40-F when used as Exchange Act registration statements. However, a filer is permitted to voluntarily submit an interactive data exhibit with these registration statements.

4. Initial Filing Grace Period

As noted above, interactive data will be required at the same time as the rest of the filing to which it relates. However, each company's initial interactive data submission, regardless of filing type, will have a 30 day grace period, and therefore will be permitted as an amendment to a:

- periodic report on Form 10-K, 20-F, 40-F or 10-Q within 30 days after the earlier of the due date or filing date of the related report;
- Securities Act registration statement within 30 days after the filing date of the price or price range as part of the related registration statement;[194] or
- report on Form 8-K or 6-K that contains revised or updated financial statements that have been revised to reflect a subsequent event rather than the correction of an error within 30 days after the filing date of the related report.

In addition, as noted above, in year two for the first filing that is required to have footnotes and schedules tagged using all levels of detail, the interactive data exhibit will be required within 30 days after the due date or filing date of the related registration statement or periodic, current or

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[194] The 30 day grace period would begin for a Securities Act registration statement once the price or price range is filed as part of it because it is at that time the interactive data filing requirement becomes applicable.

transition report or Form 6-K, as applicable.

In the voluntary program, filers were permitted to provide the interactive data at the time of filing or at any later time, without a deadline.[195] We believe that, consistent with our view regarding the potential value of widespread market use of the interactive data, companies should be required to provide the interactive data at the time the registration statement or report is filed or required to be filed, whichever is earlier. We do not believe this timing requirement will place undue pressure on filers as experience with tagging financial statements grows and software and taxonomies develop. We believe, for example, based on our experience with the voluntary program, that the time period for the quarterly or annual report is sufficient for filers to convert their ASCII or HTML financial statements into interactive data format and that the initial grace periods help to alleviate concerns over timing burdens.

Commenters overwhelmingly supported a 30 day grace period for the initial submission and initial detail tagged footnote submission of interactive data and many supported a 30 day grace period for additional submissions during the phase-in and, in some cases, beyond.[196]

Some commenters suggested that the grace period apply either for all interactive data

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[195] The voluntary program permits filers to provide financial information in interactive data form as an exhibit to a report on Form 8-K or Form 6-K when the related traditional format financial statements appear in a registration statement or periodic report. The new rules, however, will require that interactive data be provided as an exhibit to the registration statement or periodic report that contains the related traditional format financial statements.

[196] See, e.g., letters from ACLI/AIA, AICPA, AllState, Astoria, CNW Group (CNW), Comcast, Constellation, and EEI

submissions during the first two years of the phase-in period,[197] or for every submission made during the entire phase-in period.[198] These commenters generally reasoned that during the time specified, companies and service providers still would be familiarizing themselves and developing expertise related to the tagging process and, as a result, would need time to complete the tagging process. Some of those that supported additional grace periods noted that the tagging process will be an additional step to financial statement preparation for years to come and that it will take time to integrate the interactive data process with the financial statement preparation process.[199] One commenter noted that the grace period following the filing of a Form 10-K offers little relief for smaller companies due to the number of filings prepared shortly thereafter. Specifically, this commenter noted that at many smaller companies, the staff responsible for the preparation of a Form 10-K immediately turn their time and attention to the preparation of the company's proxy statement after filing the Form 10-K. The commenter stated that a Form 10-Q is not followed by a similar series of reporting obligations, so a grace period following this report is consequently more helpful in assisting companies avoid excessive expense and burden.[200]

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[197] See, e.g., letters from Constellation, EEI, and IBM.

[198] See, e.g., letters from AllState, Astoria, Comcast, Foley & Lardner (Foley), Pfizer, and UBmatrix.

[199] See, e.g., letters from FEI and SCS.

[200] See letter from ABA.

A few commenters suggested a grace period for submissions after the phase-in period. Some stated that technical difficulties and the limited availability of support services would necessitate the permanent or temporary extension of a grace period and proposed, on an on-going basis after the initial phase-in period, that interactive data files be due within 4 or more days after the related official filing is filed. Further, these commenters believed that this type of extension would not ultimately impair the usefulness of interactive data while moving the tagging procedures out of the financial reporting preparation timeframe but still providing it to investors in a timely fashion.[201] However, other commenters were concerned that a grace period beyond the periods proposed would diminish the usefulness of interactive data submitted beyond the due date of the related official filing.[202]

We acknowledge all of these concerns and suggestions, and while we are adopting the grace periods substantially as proposed, we are deferring the start of the phase-in which we believe may help to alleviate potential burdens by giving more time to prepare the initial submission. We also believe that the eventual dropping of the grace period after the initial submissions will help to make the interactive data files more useful and relevant to investors by requiring the submissions at the same time as the related official filing.

Many commenters suggested that grace period submissions be filed as exhibits to Form

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[201] See, e.g., letters from AllState, EEI, SCS, and Southern.

[202] See, e.g., letters from CFA and EDGAR Online.

8-K or 6-K rather than as exhibits to amendments to Exchange Act periodic reports, so as to avoid negative connotations associated with the filing of an amendment.[203] One commenter even suggested the creation of new forms for these amendments to distinguish them from substantive amendments to periodic reports.[204] We acknowledge these concerns, but note that grace period submissions filed with amended periodic reports need contain only the relevant interactive data as an exhibit and therefore there should not be any confusion that the amended report is being filed for any other reason. In this regard we note that Rule 12b-15 under the Exchange Act[205] generally provides that any amendment to a filing that required a certification must contain another certification; however, we clarify that, consistent with the exclusion of interactive data from the disclosure certification requirements discussed in part II.C.4 below, an amendment whose sole purposes is to submit interactive data as an exhibit is not subject to the certification requirements of Rule 12b-15 under the Exchange Act. We therefore adopt the rules as proposed as they relate to submitting interactive data as part of an amendment to the form containing the related traditional format financial statements.

5. Web Site Posting of Interactive Data

We believe interactive data, consistent with our new rules, should be easily accessible for

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[203] See, e.g., letters from AICPA, Constellation, Institute of Management Accountants (IMA), NAREIT, Purnhagen, and Teva Pharmaceutical Industries Limited (Teva).

[204] See letter from IBM.

[205] 17 CFR 240.12b-15.

all investors and other market participants. As such disclosure becomes more widely available, advances in interactive data software, online viewers, search engines and other Web tools may in turn facilitate improved access to and usability of the data, promoting its awareness and use. Encouraging widespread accessibility to filers' financial information furthers our mission to promote fair, orderly, and efficient markets, and facilitate capital formation. We believe Web site availability of the interactive data will encourage its widespread dissemination, thereby contributing to lower access costs for users. We therefore are requiring, generally as proposed, that each filer covered by the new rules provide the same interactive data that it will be required to provide to the Commission on its corporate Web site, if it has one, on the earlier of the calendar day it filed or was required to file the related registration statement or report, as applicable.[206] The interactive data should be accessible through the issuer's Web site address the issuer normally uses to disseminate information to investors.[207] Finally, the interactive data will

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[206] New Rule 405 of Regulation S-T contains the Web site posting requirement. We also are providing, however, that Web site posting of the interactive data will not be required until the end of any applicable grace period that applies to the submission of the interactive data to the Commission. Similarly, we are providing that Web site posting of the interactive data will not be required before submission of the interactive data when submission of the data is delayed in accordance with and during the term of any applicable hardship exemption provided under Rule 201 or 202 as proposed to be revised. Revisions to Rules 201 and 202 are more fully discussed below in Part II.E.

[207] If the issuer has a corporate Web site but does not normally disseminate information to investors through its Web site, it should provide access to the interactive data through a location on its Web site that it reasonably believes will facilitate user access to the forms. We took a similar approach to Web site posting location and 12 month time frame in connection with requiring that issuers with corporate Web sites post on their Web sites beneficial ownership reports filed with respect to their securities on Forms 3, 4 and 5 under Section 16(a) of the Exchange Act. See Section 16(a)(4)(C) [15 U.S.C. 78p(a)(4)(C)], Rule 16a-3(k) [17 CFR 240.16a-3(k)] and Release. No. 33-8230 (May 7, 2003) [68 FR 25788].

be required to be posted for at least 12 months, which is consistent with issuers' full one year reporting cycle.

We believe that access to the interactive data on corporate Web sites will enable search engines and other data aggregators to more quickly and cheaply aggregate the data and make them available to investors because the data will be available directly from the filer, instead of through third-party sources that may charge a fee. It could also transfer reliability costs of data availability to the public sector by reducing the likelihood that investors cannot access the data through the Commission's Web site due to down-time for maintenance or to increased network traffic. We also believe that availability of interactive data on corporate Web sites will make it easier and faster for investors to collect information on a particular filer if the interactive data is on the filer's Web site already, rather than if investors would be required to visit separately (for example, by hyperlink) and search the Commission's Web site for information, particularly if the investor is already searching the issuer's Web site. To help further our goals of decreasing user cost and increasing availability, we will not allow companies to comply with the Web posting requirement by including a hyperlink to the Commission's Web site.

We believe this requirement will be consistent with the increasing role that corporate Web sites perform in supplementing the information filed electronically with the Commission by delivering financial and other disclosure directly to investors. We also believe that this requirement can provide an incentive for corporations to add content to or otherwise enhance their Web sites, thereby improving investor experience. For example, we note that since 2003 issuers with corporate Web sites have been required to post on their Web sites, directly or by hyper linking to a third-party Web site such as the Commission's Web site, beneficial ownership reports filed with respect to their securities on Forms 3, 4, and 5. We also note that many companies provide on their Web sites access to their periodic reports, proxy statements, and other Commission filings.[208] The new rules will expand such Web site posting by requiring companies with Web sites to post their interactive data as well.[209]

Commenters had mixed views on the proposed Web site posting requirement. Some commenters stated that it would be appropriate for a company to post interactive data on its Web site because, for example, many users of financial statements access such types of information through corporate Web sites.[210] Other commenters objected to the Web site posting requirement, citing reasons including cost,[211] lack of investor benefit,[212] and facilitating use of information out of context.[213] Finally, some commenters addressed posting details such as when the interactive data must be posted and for how long it must remain accessible.

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[208] Companies filing registration statements and accelerated filers and large accelerated filers in their periodic reports are required to disclose whether or not they make available free of charge on or through their Web site, if they have one, their annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports. Companies that do not make their reports available in that manner also must disclose the reasons they do not do so and whether they voluntarily provide electronic or paper copies of their filings free of charge upon request. See Item 101(e) of Regulation S-K.

[209] As further discussed in Part II.E, under the new rules a company that fails to post its interactive data as required will be deemed ineligible to use short form registration Forms S-3, S-8, and F-3 and will be deemed not to have adequate public information available for purposes of Rule 144(c)(1) unless and until it posted.

[210] See, e.g., letters from FEI, CFA and UTC.

[211] See, e.g., letters from IBM and Starkman.

[212] See, e.g., letters from Starkman and VEC.

[213] See, e.g., letters from ABA and SCS.

We believe that issuers that already have corporate Web sites can post interactive data at a reasonable cost[214] and that such posting can benefit investors by facilitating their access to interactive data[215] and, as a result, facilitating their automated parsing and analysis of financial information. Investors and analysts routinely parse information out of filed financial statements, whether in paper or electronic format. Interactive data merely facilitates the parsing.[216] In this regard, an issuer that wishes to provide access to context beyond the posted interactive data would be free to indicate on its Web site where a user could access the Commission filing to which the interactive data is an exhibit. Similarly, an issuer could provide access to the remainder of the filing directly on its Web site or by hyperlink to the Commission's Web site.

Several commenters suggested that issuers not be required to post interactive data on corporate Web sites on the same day they are submitted to the Commission because that would be too burdensome.[217] Commenters suggested grace periods to post such data such as 24

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[214] See Part IV.

[215] One commenter stated that an issuer should be able to satisfy its posting requirement through a hyperlink. See letter from IBM. Similarly, another commenter suggested dropping the posting requirement because the information would be available on the Commission's Web site and the requirement would be difficult to monitor. See letter from E&Y. We believe, however, that search engines and other data aggregators might be better able to access the posted information directly from issuers' Web sites.

[216] We believe that parsing information in a filing is useful but we continue to emphasize the need to evaluate the entirety of a filing.

[217] See, e.g., letters from Foley, Liberty Global, Inc. (LGI), NYCBA, Southern, and Teva.

hours[218] or, in the case of foreign private issuers, two business days[219] after the related form has been filed with the Commission. As proposed, issuers would have been required to post the interactive data by the end of the business day on the earlier of the date the interactive data is submitted or is required to be submitted to the Commission. In order to make it easier for issuers to satisfy the posting requirement by providing several more hours in which to comply but still have the posted information available in a timely manner, the new rules, as adopted, will require posting by the end of the calendar rather than business day specified.

One commenter recommended that the Commission clarify the length of time that issuers would be required to keep interactive data posted.[220] As result, we are revising the proposed rules to require that an issuer keep the information posted for at least 12 months. As we stated in connection with adopting a 12-month posting period for Forms 3, 4 and 5,[221] we believe that such a period strikes an appropriate balance between the issuer effort needed to post and the investor benefit from having access to the posted material through the additional source of the issuer's Web site. In this regard, we note that the interactive data would be available indefinitely on the Commission's Web site.[222]

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[218] See, e.g., letter from LGI.

[219] See, e.g., letter from Teva.

[220] See letter from ABA.

[221] Rule 16a-3(k) [17 CFR 240.16a-3(k)].

[222] See Release No. 33-8230 (May 7, 2003) [68 FR 25788].

C. Accuracy and Reliability of Interactive Data

1. Voluntary Program

Data must be accurate to be useful to investors. To help assure the accuracy of interactive data in the voluntary program, the data, upon receipt by our electronic filing system, undergoes a validation separate from the normal validation of the traditional format filing.[223] Potential liability also helps ensure the accuracy and reliability of the data. Although the voluntary program has provided limited protections from liability under the federal securities laws[224] and excluded interactive data from being subject to officer certification requirements under Exchange Act Rules 13a-14 and 15d-14,[225] interactive data in the voluntary program are subject to the anti-fraud provisions of the federal securities laws. The voluntary program also encourages participants' efforts to create accurate and reliable interactive data that is the same as the corresponding disclosure in the traditional electronic format filing by providing that a participant is not liable for information in its interactive data that reflects the same information that appears in the corresponding portion of the traditional format filing, to the extent that the information in the corresponding portion of the traditional format filing was not materially false

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[223] If the traditional format filing meets its validation criteria, but any interactive data fail their own validation criteria, all interactive data are removed and the traditional format filing is accepted and disseminated without the interactive data file.

[224] Rule 402 under Regulation S-T provides these liability protections.

[225] See Rules 13a-14(f) [17 CFR 240.13a-14(f)] and 15d-14(f) [17 CFR 240.15d-14(f)].

or misleading. To further encourage reasonable efforts to provide accurate interactive data, the voluntary program treats interactive data that do not reflect the same information as the official version as reflecting the official version if the volunteer meets several conditions. The volunteer must have made a good faith and reasonable attempt to reflect the same information as appears in the traditional format filing and, as soon as reasonably practicable after becoming aware of any difference, the volunteer must amend the interactive data to cause them to reflect the same information.[226]

2. Use of Technology to Detect Errors

Complete, accurate, and reliable financial statements and other disclosures are essential to investors and the proper functioning of the securities markets. Our new requirement to submit interactive data with registration statements and reports is designed to provide investors with new tools to obtain, review, and analyze information from public filers more efficiently and effectively. To satisfy these goals, interactive data must meet investor expectations of reliability and accuracy. Many factors, including companies' policies and procedures as buttressed by incentives provided by the application of technology by the Commission, market forces and the liability provisions of the federal securities laws, help further those goals.

Building on the validation criteria referenced above for interactive data in the voluntary program, we plan to use validation software to check interactive data for compliance with many

[226] 17 CFR 232.402(b).

of the applicable technical requirements and to help the Commission identify data that may be problematic. For example, we expect the Commission's technology to:

- check if required conventions (such as the use of angle brackets to separate data) are applied properly for standard and, in particular, non-standard special labels and tags;
- identify, count, and provide the staff with easy access to non-standard special labels and tags;[227]
- identify the use of practices, including some the XBRL U.S. Preparers Guide contains, that enhance usability;[228]
- facilitate comparison of interactive data with disclosure in the corresponding traditional format filing;
- check for mathematical errors; and
- analyze the way that companies explain how particular financial facts relate to one another.[229]

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[227] For example, if a company uses the word "liabilities" as the caption for a value data tagged as "assets," the software would flag the filing and bring it to the staff's attention. In contrast, if the company used "Total Assets" or "Assets, Total," the software would identify the use of these terms as a low risk discrepancy.

[228] The XBRL U.S. Preparers Guide, available from the XBRL U.S. Web site, provides guidance to facilitate preparing information in the interactive data format.

[229] The technology used to show these relationships is known as a "linkbase." Linkbases are part of an XBRL taxonomy and serve one of two primary purposes: (1) to define additional information about a particular concept (for example to express the definition for Inventory or to express the authoritative references for Inventory); and (2) to express relationships between different concepts (for example Inventory adds up to Current Assets or Inventory appears after Accounts Receivable on the balance sheet, but before Prepaid Expenses). The Commission will seek

The availability of interactive data to the staff may also enhance its review of company filings. After the FDIC required submission of interactive data, it reported that its analysts were able to increase the number of banks they reviewed by 10% to 33%, and that the number of bank reports that failed to fully meet filing requirements fell from 30% to 0%.[230]

We believe analysts, individual investors and others outside the Commission that use the interactive data submitted to us also will make use of software and other tools to evaluate the interactive data and, as a result, market forces will encourage companies to provide interactive data that accurately reflects the corresponding traditional format data in the traditional format filing. For example, the use of non-standard special labels or tags (extensions) could introduce errors, but we expect the open source and public nature of interactive data and the list of tags for U.S. financial statement reporting would enable software easily to detect and identify any modifications or additions to the approved list of tags. Based on our knowledge of the existing software market, we believe such software and other technology will be widely available for free or at reasonable cost. Investors, analysts, and other users therefore would be able to identify the existence and evaluate the validity of any such modifications or additions. We also anticipate that companies preparing their interactive data and investors, analysts, and other users will use

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to ensure that linkbases not only comply with technical requirements but also are not used to evade accounting standards.

230 These bank reports require information that is more structured and less varied than the information we will require. As a result, the FDIC's efficiency gains from the use of interactive data likely would be greater than ours.

such devices to search for and detect any changes made to the standard list of tags. The ability of analysts and other users to discover mistakes or alterations not consistent with the desired use of interactive data may give filers an additional incentive to prepare such data with care and promptly to correct any errors.

3. Application of Federal Securities Laws

An interactive data file generally will be subject to the federal securities laws in a modified manner similar to that of the voluntary program under new Rule 406T if the filer submits the interactive data file within 24 months of the time the filer first is required to submit interactive data files[231] but no later than October 31, 2014.[232] Rule 406T provides that during the time a filer's interactive data files are treated in this modified manner, they will be

- subject to specified anti-fraud provisions[233] except in connection with a failure to comply with the tagging requirements that occurs despite a good faith attempt to comply and is corrected promptly after the filer becomes aware of the failure;

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[231] The 24-month period would be exclusive of a grace period. For example, a large accelerated filer first required to submit interactive data for financial statements in a Form 10-Q for the fiscal period ended June 30, 2009, would be required to submit the interactive data by 30 days after the Form 10-Q's August 10, 2009 due date but its 24-month period would end August 10, 2011.

[232] In regard to liability and also similar to the voluntary program, we are adopting as proposed an exclusion for interactive data files from the officer certification requirements of Rules 13a-14 and 15d-14 of the Exchange Act. That exclusion is discussed further below in Part II.C.4.

[233] The specified anti-fraud provisions are Section 17(a)(1) of the Securities Act [15 U.S.C. 77q(a)(1)], Section 10(b) [15 U.S.C. 78j(b)] of and Rule 10b-5 [17 CFR 240.10 b-5] under the Exchange Act and Section 206(1) [15 U.S.C. 80b-6(1)] of the Investment Advisers Act of 1940 [15 U.S.C. 80b-1 et seq.].

- deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act and not otherwise subject to liability under these sections;
- deemed not filed for purposes of Section 18 of the Exchange Act or Section 34(b) of the Investment Company Act and not otherwise subject to liability under these sections; and
- deemed filed for purposes of (and, as a result, benefit from) Rule 103 under Regulation S-T.[234]

In regard to correcting an interactive data file, we are adding the term "promptly" to the list of defined terms in Rule 11 under Regulation S-T. Rule 11 defines "promptly" as "as soon as reasonably practicable under the facts and circumstances at the time." The definition is followed by a non-exclusive safe harbor. The safe harbor generally provides that a correction made by the later of 24 hours or 9:30 a.m. on the next business day after the filer becomes aware of the need for the correction is deemed promptly made. If a filer fails to correct within the safe harbor

[234] Interactive data files will be deemed filed for purposes of Rule 103 under Regulation S-T [17 CFR 232.103] and, as a result, the issuer will not be subject to liability for electronic transmission errors beyond its control if the issuer corrects the problem through an amendment as soon as reasonably practicable after the issuer becomes aware of the problem. Interactive data files will be deemed filed for purposes of Rule 103 regardless whether they are eligible for the modified treatment provided by Rule 406T at the time submitted. Rule 406T expressly provides that interactive data files are deemed filed for purposes of Rule 103 to remove any negative inference that otherwise might be drawn due to the fact that Rule 406T deems interactive data files to be not filed for other specified purposes.

timeframe, the filer still may have corrected promptly depending on the applicable facts and circumstances.

Despite the modified treatment of interactive data files under the federal securities laws, a filer would be subject to actions under circumstances where the protections of new Rule 406T do not apply. For example, the Commission could bring an action against a filer under Section 13(a) of the Exchange Act if the filer submits an interactive data file with a periodic report and the interactive data file fails to comply with the tagging requirements despite a good faith attempt, where the filer fails to correct the interactive data file promptly after it discovers the failure. On the other hand, the Commission would not be able to bring an action against a filer under Sections 17(a)(2) and (3) under the Securities Act if the filer submits an interactive data file with a Securities Act registration statement if the interactive data file fails to comply despite a good faith effort but the filer acted negligently.

New Rule 406T differs from proposed Rule 406 primarily by omitting reference to interactive data in viewable form and applying only for a specified time.

We believe that interactive data in viewable form are best addressed in relation to interactive data files and traditional concepts of liability. Interactive data in viewable form that are displayed on the Commission's Web site will reflect the related interactive data file and, as a result, such interactive data in viewable form should be treated in the same manner as the related interactive data file in regard to a filer's failure to correctly tag an interactive data file that results in a failure of the interactive data in viewable form to reflect the related official filing. Interactive data in viewable form that are displayed on other Web sites would be subject to general anti-fraud principles applicable to republication of another person's statements.[235] Consistent with traditional concepts of liability, a filer would incur no additional liability for a failure that occurs in both an interactive data file and the related interactive data in viewable form.

We believe that limiting the modified application of the federal securities laws to a specified period improves the balance between avoiding unnecessary cost and expense and encouraging accuracy in regard to interactive data because it recognizes that issuers and service providers likely will grow increasingly skilled at and comfortable with the tagging requirements.

In the proposing release, the Commission sought comment on modified treatment of interactive data under the federal securities laws. Commenters overwhelmingly supported limiting liability,[236] with a fair number of commenters supporting the proposed approach, and a fair number suggesting that the proposed approach be made less stringent. One expressed the concern that the proposed approach should be made more stringent.[237] A significant number

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[235] These general anti-fraud principles include the concepts of aiding and abetting and control person liability. In addition, liability for interactive data in viewable form displayed by third parties would depend in part on whether that information is attributable to the filer. See, e.g., Release No. 34-58288 (Aug. 7, 2008) at Section II.B.2.

[236] See, e.g., letters from ABA and IBM.

[237] See letter from CII.

stated that the regulatory text was confusing or unclear, especially as to viewable interactive data. Finally, a few commenters made other liability-related suggestions, sought clarification of the liability applicable to situations not intended to be addressed expressly by the proposed rules or expressed other concerns.

Commenters supporting the proposed approach generally supported having interactive data files be deemed furnished rather than filed.[238] New Rule 406T is consistent with the proposals and these comments because it deems interactive data files not filed for purposes of various provisions under the federal securities laws.

Commenters suggesting that the proposed approach be made less stringent did so explicitly and implicitly. For example, while the proposals generally provided that an interactive data file would be protected from federal securities law liability if the issuer made a good faith attempt to prepare it correctly, one commenter criticized the good faith requirement explicitly[239] and others did so implicitly by stating there should be no liability where there is no affirmative intent to mislead.[240] The commenter that criticized the good faith requirement explicitly stated that it would be problematic because there would be litigation over its fulfillment. Upon further reflection and in light of these comments, new Rule 406T requires a "good faith attempt" to

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[238] See, e.g., letters from AICPA, Deloitte, NYCBA, SavaNet LLC (SavaNet), and UTC.

[239] See letter from S&C.

[240] See, e.g., letters from Angel, Intel, LG, SCS, Southern, and USS.

comply with the tagging requirements rather than the proposed "good faith and reasonable attempt." We believe that omission of the reference to "reasonable" should not result in a lesser degree of effort by issuers but should help to avoid litigation over fulfillment of the requirement. As discussed in detail above, under new Rule 406T additional liability protection occurs when a filer makes a good faith attempt and corrects any failure to comply with the tagging requirements promptly after the filer becomes aware of the failure. In this context, we interpret "good faith" as not having the scienter required for purposes of the anti-fraud provisions.[241] In a further effort to help clarify what constitutes adequate effort for purposes of receiving additional liability protection and as also discussed in detail above, we have adopted a definition for the term "promptly" that includes a non-exclusive safe harbor.

Three commenters suggested that, at least at the outset of the interactive data submission requirement, there should be essentially no liability based on interactive data files or viewable interactive data.[242] Two of these commenters stated that there should be no liability because tagging would be a "new" process.[243] The third commenter stated that interactive data are merely a repetition, in another format, of information already required and there would be little risk that issuers would affirmatively try to introduce differences between the formats because any such

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[241] See Ernst & Ernst v. Hochfelder, 425 US 185, 206 (1976).

[242] See letters from NYCBA, Safeway, and S&C.

[243] See letters from NYCBA and Safeway.

differences would be transparent. Similarly, one commenter stated there should be no liability attributable to the posting of an interactive data file because the information would be out of context.[244] We acknowledge these comments but, in general, believe the measured level of liability that would apply at the outset of the mandated program is appropriate in light of the current level of development in tagging processes and the effect this level of liability should have on helping to assure that interactive data are reliable.[245]

Some commenters that supported limited liability at least at the outset of the interactive data submission requirement suggested that liability be revisited[246] or increased[247] later. Similarly, one commenter suggested that the imposition of liability on viewable interactive data be conditioned on the maturity of the tagging and rendering technology.[248] In that regard, three commenters suggested that the good faith exception proposed for the interactive data file in part could form the basis for an exemption for viewable interactive data.[249] As discussed above, we have decided to limit liability at the outset of the mandated program but phase out the limitation of liability over time. We believe that treatment of interactive data in viewable form that appears

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[244] See letter from SCS.

[245] See Part II.B.5 for a discussion of commenter concerns regarding interactive data's being out of context.

[246] See, e.g., letters from AICPA, E&Y, and Grant Thornton.

[247] See, e.g., letters from SavaNet and UTC.

[248] See letter from ABA.

[249] See, e.g., letters from ABA, E&Y, and IBM.

on our Web site in a manner analogous to the treatment of the related interactive data file for liability purposes is appropriate in light of the maturity of tagging and rendering technology. Similarly, we believe that treatment of interactive data in viewable form that appears on other Web sites under general anti-fraud principles applicable to republication of another person's statements also is appropriate in light of the maturity of such technology.

Commenters stated that the regulatory text was confusing or unclear in various ways, with a focus on viewable interactive data. In terms of specific items, commenters singled out, for example, the proposed Rule 406(c)(3)(C) provision attempting to draw a distinction between substantive content and compliance with the tagging provisions of proposed Rule 405.[250] In terms of general items and viewable interactive data, commenter concerns often related to the fact that the proposed rules expressly addressed viewable interactive data only to the extent, as converted by the Commission's viewer, it appeared identical in all material respects to the related official filing. As a result, commenters indicated that it was unclear what liability applied to viewable interactive data as rendered by the Commission's viewer, not identical in all material respects to the related official filing; and as rendered by a non-Commission viewer.[251] We believe that new Rule 406T clarifies or omits the provisions of proposed Rule 406 that commenters found confusing. As to viewable interactive data in particular, we now omit

[250] See letters from ABA, Intel, and SCS.

[251] See, e.g., letters from ABA and S&C.

reference in the rule to one particular situation in favor of addressing viewable interactive data in general under traditional legal and liability concepts as discussed in detail above.

We did not propose to permit or require legends for interactive data files. One commenter expressly approved the absence of a legend requirement,[252] but four commenters suggested variously that the Commission require a legend that states people should not rely on the interactive data,[253] that they should not rely on it because of limited liability,[254] or that people should not use the interactive data in isolation.[255] We believe that attempting to place in interactive data legends of the type suggested would be impracticable because interactive data will often be accessed in their machine-readable form and, even if they were accessed in viewable form, might not be accessed in a place where the legend would appear. As to a legend that states people should not rely on the interactive data in particular, such a legend would be unnecessary because there is no reason the data should not be reliable and, were they not reliable, they would have little value.

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[252] See letter from CFA. Under the current voluntary program, the filing with which interactive data are submitted must disclose that the purpose of the interactive data is to test the related format and technology and, as a result, investors should not rely on the interactive data in making investment decisions.

[253] See, e.g., letters from AICPA, CAQ and PWC.

[254] See letters from CAQ and PWC.

[255] See letter from ABA.

To assist filers in ensuring the accuracy of their interactive data submissions, we plan to make available to filers the opportunity to make a test submission with the Commission. The test submission will enable the filer to learn how the validation system would respond if the test submission were a live submission and then, if the filer wishes, use the Commission's pre-viewer to see the viewable interactive data that would be displayed on the Commission Web site if the interactive data were accepted and disseminated.[256] If the validation system finds an error, it will advise the filer of the nature of the error and as to whether the error was major or minor. As occurs in the voluntary program, a major error in an interactive data exhibit that was part of a live filing will cause the exhibit to be held in suspense in the electronic filing system. The rest of the filing will be accepted and disseminated if there are no major errors outside of the interactive data exhibit. If that were to happen, the filer will need to revise the interactive data exhibit to eliminate the major error and submit the exhibit as an amendment to the filing to which it is intended to appear as an exhibit. A minor error in an interactive data exhibit that is part of a live filing will not prevent the interactive data exhibit from being accepted and disseminated together with the rest of the filing if there are no major errors in the rest of the filing. We believe it will be appropriate to accept and disseminate a filing without the interactive data exhibit submitted with it if only the exhibit has a major error, in order to disseminate at least as much information at least as timely as would have been disseminated were there no interactive data requirement.

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[256] The EDGAR Filer Manual addresses test submissions primarily at Section 6.6.5 of Volume II.

Some commenters sought clarifications on whether there might be auditor liability on interactive data files.[257] There is no additional basis for auditor liability based on data tagging. Also, an auditor will not be required to apply AU Sections 550, 711 or 722 to interactive data provided in an exhibit or to the related viewable interactive data.[258]

In this regard, we also note that we are not requiring that filers involve third parties, such as auditors or consultants, in the creation of their interactive data filings. We are taking this approach after considering various factors, including:

- commenters' views;
- the availability of a comprehensive list of tags for U.S. financial statement reporting from which appropriate tags can be selected, thus reducing a filer's need to develop new elements;[259]
- the availability of user-friendly software with which to create the interactive data file;
- the multi-year phase-in for each filer, the first year of which entails the relatively straightforward process of tagging face financial statements, as was done during the voluntary program, and block tagging footnotes and financial statement schedules;
- the availability of interactive data technology specifications, and of other XBRL U.S.,

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[257] See e.g., letter from E&Y.

[258] See Part II.C.4 below for a further discussion of AU Sections 550, 771 and 722.

[259] We expect the same will be true with respect to the tags for reporting under IFRS as issued by the IASB.

XBRL International, and Commission resources for preparers of tagged data;[260]

- the advances in rendering/presentation software and validation tools for use by preparers of tagged data that can identify the existence of certain tagging errors;
- the expectation that preparers of tagged data will take the initiative to develop practices to promote accurate and consistent tagging; and
- the filer's and preparer's liability for the accuracy of the traditional format version of the financial statements.

Many commenters believed that issuers should not be required to obtain auditor assurance on their interactive data submissions at least at the outset of the interactive data submission requirement,[261] but a few commenters favored requiring assurance to enhance reliability.[262] Some commenters suggested monitoring interactive data submissions and considering whether to introduce an assurance requirement in the future.[263] We acknowledge the

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[260] An example of Commission resources includes the EDGAR Filer Manual.

[261] See, e.g., letters from AICPA, Deloitte, FEI, Gen. Mills, IMA, Illinois Society of Certified Public Accountants (ILSCPA), and Teva.

[262] See, e.g., letters from CalPERS, CFA and CII. In connection with stating their concerns about the lack of auditor assurance, two of these commenters also stated their concern about the absence of management certification of interactive data under the proposed exclusion of interactive data from the officer certification requirements of Rules 13a-14 and 15d-14. See letters from CFA and CII.

[263] See, e.g., letters from AICPA, CAQ, Deloitte, E&Y, Grant Thornton, and KPMG.

concerns of the commenters that believe we should require assurance on interactive data. For the reasons discussed above, however, we believe an assurance requirement is not now necessary.

A number of commenters, including many representing the auditing profession, recommended that the Commission and the PCAOB provide guidance to issuers and auditors for situations where an issuer wanted to voluntarily obtain some form of auditor assurance on interactive data.[264] We note that issuers can obtain third-party assurance under the PCAOB Interim Attestation Standard—AT sec. 101, Attest Engagements on interactive data, and can start and stop obtaining assurance whenever they choose.[265] We understand that the PCAOB is aware of sentiment in favor of interactive data-specific attestation standards.

Auditing firms generally did not support requiring issuers to obtain auditor assurance on data tagging, and stated their concern that users of interactive data financial statements may incorrectly assume that auditor assurance has been provided on the data tagging.[266] These auditing firms recommended:

- requiring issuers' filings to specify clearly the extent of auditor involvement with the interactive data exhibit;[267]

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[264] These included tagging in general (see, e.g., letters from AICPA and UTC); extensions (see, e.g., letters from AICPA and UTC); and correct associated data (see, e.g., letter from UTC).

[265] If an issuer wishes to refer in a filing to third party assurance voluntarily obtained from an auditor or other party, the issuer must comply with applicable consent requirements.

[266] See, e.g., letters from CAQ, Deloitte, E&Y, Grant Thornton, KPMG, and PWC.

[267] See, e.g., letters from Deloitte, Grant Thornton, and PWC.

- requiring the interactive data submission to state that it is not subject to assurance when no assurance has been provided;[268]
- prohibiting tagging the auditor's report;[269] and
- revising the standard audit report to clarify the extent to which, if any, the audit extends to interactive data.[270]

Some commenters suggested monitoring the interactive data submission program and considering whether to introduce an assurance requirement in the future.[271] As stated previously, the Commission does not believe that auditor involvement is necessary with respect to the interactive data file. We also believe that the rules as adopted address some of the commenters' concerns regarding the perception of auditor involvement in the creation of the interactive data exhibit. Although Rule 405 as adopted does not include a requirement that auditors' reports be tagged, the rules do not prohibit issuers from indicating in the financial statements (such as in a footnote) the degree of auditor involvement in the tagging process. Accordingly, we believe that an issuer can make clear the level of auditor involvement or lack thereof in the creation of the interactive data exhibit.

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[268] See, e.g., letters from Deloitte, E&Y and Grant Thornton.

[269] See, e.g., letters from CAQ, Deloitte, E&Y, Grant Thornton, and KPMG.

[270] See, e.g., letter from Deloitte.

[271] See letters from AICPA, CAQ, Deloitte, E&Y, GT, and KPMG.

4. Officer Certifications and Integration of Interactive Data and Business Information Processing

Rules 13a-14 and 15d-14 generally require officers to certify in periodic reports to various matters relating to internal control over financial reporting[272] and disclosure controls and procedures.[273]

We are adopting amendments that exclude interactive data from the officer certification requirements of Rules 13a-14 and 15d-14. We believe that adopting these amendments is part of striking an appropriate balance between avoiding unnecessary cost and expense and encouraging accuracy in regard to interactive data. A number of commenters stated that interactive data submissions should not be included within the scope of officer certifications,[274] but two commenters expressed concern about the exclusion[275] and one commenter recommended that

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[272] Exchange Act Rules 13a-15(f) [17 CFR 240.13a-15(f)] and 15d-15(f) [17 CFR 240.15d-15(f)] define the term "internal control over financial reporting," in general, as a process designed by or under the supervision of specified persons and effected by the issuer's board of directors, management and other personnel "to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with [GAAP] and includes [specified] policies and procedures." Rules 13a-15 and 15d-15 generally require specified issuers to maintain internal control over financial reporting and require the management of those issuers to evaluate the effectiveness of the issuer's internal control over financial reporting. In addition, the certifications specified by Item 601(b)(31) of Regulation S-K and Instruction B(e) of Form 20-F that relate to these specified issuers, generally must address the establishment, maintenance, design, changes in and deficiencies and material weaknesses related to the issuer's internal control over financial reporting.

[273] Rules 13a-15(e) and 15d-15(e) define the term "disclosure controls and procedures" as "controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in [its periodic] reports . . . is recorded, processed, summarized and reported within the time periods [required]."

[274] See, e.g., letters from FirstEnergy, LGI, NYCBA, Safeway, Southern, Teva, USS, and WellPoint.

[275] See letters from CFA and CII.

they be included after the two-year phase-in period.[276] The commenters supporting the exclusion cited varying reasons including, for example, that an officer should not be required to certify to data that is not human-readable[277] and that inclusion would result in increased expense and exposure without commensurate investor benefit.[278] The commenters expressing concern cited the exclusion together with the absence of an auditor assurance requirement as together resulting in less confidence in the interactive data than in traditional format information. As stated above in regard to liability generally, we believe that adopting the officer certification exclusion is part of striking an appropriate balance between avoiding unnecessary cost and expense and encouraging accuracy. We intend to monitor implementation and, if necessary, make appropriate adjustments in the future regarding officer certifications.

As the technology associated with interactive data improves, issuers may integrate interactive data technology into their business information processing, and such integration may have implications regarding internal control over financial reporting no different than any other controls or procedures related to the preparation of financial statements. If this integration occurs, the preparation of financial statements may become interdependent with the interactive data tagging process and an issuer and its auditor should evaluate these changes in the context of

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[276] See letter from AICPA.

[277] See letter from Safeway.

[278] See letter from NYCBA.

their reporting on internal control over financial reporting. However, this evaluation is separate from the preparation and submission of the interactive data file, and as such the results of the evaluation would not require management to assess or an auditor to separately report on the issuer's interactive data file provided as an exhibit to a filer's reports or registration statements.

Some commenters sought clarification of whether the basis for the proposed exclusion of interactive data from officer certification is that interactive data are not within the scope of disclosure controls and procedures.[279] In this regard, one of the commenters noted that the Commission did not propose amendments related to Sarbanes-Oxley requirements to Items 307 (disclosure controls and procedures), 308 (internal control over financial reporting) or 601 (exhibits) of Regulation S-K. As a result, the commenter recommended that the final rule explicitly address these areas to avoid misunderstandings and potential delays in implementation.[280] As discussed above, we are excluding interactive data from the officer certification requirements as part of our effort to strike an appropriate balance between avoiding unnecessary cost and expense and encouraging accuracy in regard to interactive data. Interactive data would fall within the definition of "disclosure controls and procedures" and, accordingly, we are not adopting the exclusion on that basis.

SAS 8 (AU Section 550) was issued in December 1975 to address an auditor's

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[279] See, e.g., letters from Deloitte and KPMG.

[280] See letter from KPMG.

consideration of information in addition to audited financial statements and the independent auditor's report on the audited financial statements included in documents that are published by an entity (e.g., an annual periodic report). Similarly, paragraph 18(f) of SAS 100 (AU Section 722) addresses an auditor's consideration of other information that accompanies interim financial statements included in quarterly periodic reports. With respect to registration statements, SAS 37 (AU Section 711) was issued in April 1981 to address the auditor's responsibilities in connection with filings under the federal securities statutes.

As we stated in the proposing release in regard to the proposed rules, with respect to the adopted rules, an auditor will not be required to apply AU Sections 550, 722, or 711 to the interactive data provided as an exhibit in a company's reports or registration statements, or to the viewable interactive data. Several commenters agreed that an auditor would not be required to apply AU Sections 550, 711 or 722 to the interactive data provided as an exhibit or to the related viewable interactive data but wanted the PCAOB to formalize that view.[281] We understand that the PCAOB is aware of this matter.

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[281] See, e.g., letters from BDO, CAQ Deloitte, E&Y and PWC.

5. Continued Traditional Format

The new rules will not eliminate or alter existing filing requirements that financial statements and financial statement schedules be filed in traditional format. We believe investors and analysts may wish to use the traditional format to obtain an electronic or printed copy of the entire registration statement or report either in addition to or instead of disclosure formatted using interactive data.

The vast majority of commenters stated that the Commission should continue to require human-readable financial statements in traditional format even if it required interactive data format as well.[282] Most of these commenters also stated that the Commission should monitor the development of technology that could enable companies to file information in a manner that provides the processing benefits of interactive data and the visual clarity of the traditional format. These commenters reasoned that when such technology is developed, it would be appropriate to require only the single resulting format.

D. Required Items

1. Data Tags

To comply with the proposed rules, filers using U.S. GAAP will be required to tag their financial statements using the most recent list of tags for U.S. financial statement reporting, as

[282] See, e.g., letters from Southern, AICPA, IBM, National City, NYSSCPA, and UTC.

released by XBRL U.S. and required by the EDGAR Filer Manual.[283] Each company will be required to use one or more of the five standard industry-specific lists identified in the EDGAR Filer Manual, as is appropriate for its business.[284]

Regular updates to the list of tags for U.S. financial statement reporting will likely be posted annually and be available for downloading. In addition, interim extensions may be made available for download in order to reflect changes in accounting and reporting standards. To provide companies sufficient time to become familiar with any such updates, we anticipate giving advance notice before requiring use of an updated list of tags. Based on experience to date with the most recent update to the list of tags, we believe that it is sufficiently developed to support the interactive data disclosure requirements in the new rules.

Similarly, filers using IFRS as issued by the IASB will be required to tag their financial information using the most recent list of tags for international financial reporting, as released by the IASCF and specified in the EDGAR Filer Manual.[285] Although IFRS tags are not currently supported by EDGAR, the Commission will give notice when filers can voluntarily submit

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283 The latest list of data tags for U.S. financial statement reporting was released on April 28, 2008 and is available at http://xbrl.us/pages/us-gaap.aspx. See XBRL U.S. Press Release, XBRL US Finalizes US GAAP Taxonomies and Preparers Guide with Delivery to SEC, (May 2, 2008).

284 We note that the vast majority of companies will fall under the Commercial and Industrial industry group. Additional guidance on the industry-specific lists is expected to appear in the EDGAR Filer Manual.

285 The International Accounting Standards Committee Foundation has been developing the IFRS financial reporting tag list since 2002. See http://www.iasb.org/xbrl/index.html. The 2008 version of the IFRS financial reporting tag list was, as noted above, finalized in June 2008 and is planned to be updated annually for changes in accounting and reporting standards.

filings using the IFRS taxonomy.

One of the principal benefits of interactive data is its extensibility—that is, the ability to add to the standard list of tags in order to accommodate unique circumstances in a filer's particular disclosures. The use of customized tags, however, may also serve to reduce the ability of users to compare similar information across companies. This was the source of a significant amount of comment. Some commenters were concerned that currently available standard taxonomies do not cover many company specific extension needs and any increase in customized taxonomy extensions would directly interfere with the comparability of inter-company data.[286] A number of commenters suggested ways to facilitate interactive data tagging, which included monitoring,[287] cataloging,[288] and discouraging[289] extension use as well as revising the Preparers Guide to put it in plain English.[290]

We acknowledge these concerns. In order to promote comparability across companies, the new rules, as proposed, will limit the use of extensions to circumstances where the appropriate financial statement element does not exist in the standard list of tags. The new rules

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286 See, e.g., letter from EuropeanIssuers.

287 See, e.g., letter from CFA.

288 See, e.g., letter from ABA.

289 See, e.g., letters from Grant Thornton, CFA, Morgan Stanley, and Rivet.

290 See, e.g., letter from Grant Thornton.

also require that wherever possible and when a standard element is appropriate, preparers change the label for a financial statement element that exists in the standard list of tags, instead of creating a new customized tag. For example, the standard list of tags for U.S. GAAP includes the financial statement element "gross profit." The list does not include "gross margin," because this is definitionally the same as "gross profit"—both are generally used to mean "excess of revenues over the cost of revenues." A filer using the label "gross margin" in its income statement should use the tag corresponding to the financial statement element "gross profit." It would then change the label for this item on the standard list to "gross margin."

Finally, under Item 401(c) of Regulation S-T, voluntary filers' interactive data elements must reflect the same information as the corresponding traditional format elements. Further, no data element can be "changed, deleted or summarized" in the interactive data file.[291] We are not changing this equivalency standard for financial statements provided in interactive data format as required by the new rules.

2. Regulation S-T and the EDGAR Filer Manual

The new rules require that filers provide interactive data in the form of exhibits to related registration statements and reports.[292] Interactive data will be required to comply with our

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[291] Item 401(c)(2) of Regulation S-T.

[292] The requirement to submit XBRL data as an exhibit will appear in Item 601(b)(101) of Regulation S-K, paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of both Form F-9 and F-10, Item 101 of the Instructions to Exhibits of Form 20-F, paragraph B.7 of the General Instructions to Form 40-F and paragraph C.6 of the General Instructions to Form 6-K.

Regulation S-T[293] and the EDGAR Filer Manual. The EDGAR Filer Manual is available on our Web site. It includes technical information for making electronic filings with the Commission. Volume II of this manual includes guidance on the preparation, submission, and validation of interactive data submitted under the voluntary program.

In addition to both Regulation S-T, which will include rules we are adopting, and the instructions in our EDGAR Filer Manual, filers may access other sources for guidance in tagging their financial information. These include the XBRL U.S. Preparers Guide; user guidance accompanying tagging software; and financial printers and other service providers. New software and other forms of third-party support for tagging financial statements using interactive data are also becoming widely available.

E. Consequences of Non-Compliance and Hardship Exemption

The new rules provide, as proposed, that if a filer does not make the required interactive data submission, or post the interactive data on the company Web site, by the required due date, the filer will be unable to use short form registration statements on Forms S-3, F-3, or S-8.[294]

[293] Rule 405 of Regulation S-T directly sets forth the basic tagging and posting requirements for the XBRL data and requires compliance with the EDGAR Filer Manual. Consistent with Rule 405, the EDGAR Filer Manual will contain the detailed tagging requirements.

[294] Forms S-3, F-3, and S-8 are regarded as short form registration statements because they enable eligible issuers to register securities for offer and sale under the Securities Act by providing information in a more streamlined manner than they otherwise could. In order to be eligible to use these short forms, an issuer must meet specified requirements, including being current in its filing of Exchange Act reports. In general, an issuer is current if it has filed all of its required Exchange Act reports for the twelve months before filing the registration statement. Filers

This disqualification will last until the interactive data are provided. During the period of disqualification, the filer also will be deemed not to have available adequate current public information for purposes of the resale exemption safe harbor provided by Rule 144.[295] Once a filer complies with the interactive data submission and posting requirements—provided it previously filed its financial statement information in traditional format on a timely basis—it will be deemed to be timely and current in its periodic reports.

We believe that precluding the use of short form registration statements during any period of failure to comply will appropriately direct attention to the interactive data reporting requirement. Allowing filers to reestablish their current status by later complying with the interactive data reporting requirement will strike a reasonable balance of negative consequences and recognition that the company's traditional format reports will have been filed.

Consistent with the treatment of other applicable reporting obligations, we are adopting hardship exemptions for the inability to timely submit interactive data. Rule 201 under

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that are unable to use short form registration also are unable to incorporate by reference certain information into Forms S-4 and F-4. See Item 12 of Forms S-4 and F-4.

[295] Rule 144 under the Securities Act creates a safe harbor for the resale of securities under the exemption from Securities Act registration set forth in Section 4(1) of the Securities Act [15 U.S.C. 77d(1)]. In order for some resales of securities to comply with Rule 144, the issuer of the securities must be deemed to have adequate current public information available as specified by Rule 144(c)(1) [17 CFR 230.144(c)(1)]. Rule 144(c)(1) deems an issuer required to file reports under the Exchange Act to have adequate public information available if it is current in its filing of Exchange Act periodic reports. In general, an issuer would be deemed current for this purpose if it has filed all of its required Exchange Act periodic reports for the twelve months before the sale of securities for which the Rule 144 safe harbor is sought.

Regulation S-T provides for temporary hardship exemptions. Rule 202 under Regulation S-T provides for continuing hardship exemptions.[296]

Rule 201 generally provides a temporary hardship exemption from electronic submission of information, without staff or Commission action, when a filer experiences unanticipated technical difficulties that prevent timely preparation and submission of an electronic filing. The temporary hardship exemption permits the filer to initially submit the information in paper but requires the filer to submit a confirming electronic copy of the information within six business days of filing the information in paper. Failure to file the confirming electronic copy by the end of that period results in short form ineligibility.[297]

We recognize the inherently electronic nature of interactive data. In light of this and the consequences to an issuer of not timely submitting interactive data, we are revising Rule 201, as proposed, to provide a temporary hardship exemption that does not depend upon filing a paper version. This exemption will apply without staff or Commission action if a filer experiences unanticipated technical difficulties that prevent the timely preparation and electronic submission

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[296] We have amended Rule 12b-25 [17 CFR 240.12b-25] under the Exchange Act, which, in general, deals with notification of the inability to timely file or submit all or part of specified forms and deems such forms to be timely filed under specified conditions. We added paragraph (h) to state that the provisions of the rule do not apply to interactive data files and that filers unable to submit or post interactive data files when required must comply with the hardship exemption requirements of either Rule 201 or 202 of Regulation S-T. New paragraph (h) will treat interactive data files in a manner similar to that which current Rule 12b-25(g) treats electronic filings in general. When Rule 12b-25 provides that the financial statements in traditional format are deemed filed timely even though actually filed later, the related interactive data exhibit must be submitted and posted on the date the related traditional format financial statements are actually filed, not when they are deemed to be filed under Rule 12b-25.

[297] Rule 201 of Regulation S-T.

of interactive data. The revised temporary hardship exemption will cause the filer to be deemed current for purposes of incorporation by reference, short form registration, and Rule 144 for a period of up to six business days from the date the interactive data were required to be submitted.[298] If the filer does not electronically submit the interactive data by the end of that period, from the seventh business day forward the filer will not be deemed current until it does electronically submit the interactive data. Similarly, we are revising Rule 201 to provide an essentially mirror-image exemption from the new requirement for an issuer that has a corporate Web site to post the interactive data on its Web site.

Rule 202 permits a filer to apply in writing for a continuing hardship exemption if information otherwise required to be submitted in electronic format cannot be so filed without undue burden or expense. If the Commission or the staff, through authority delegated from the Commission, grants the request, the filer must file the information in paper by the applicable due date and file a confirming electronic copy if and when specified in the grant of the request.

We are revising Rule 202, as proposed, to provide that a grant of a continuing hardship exemption for interactive data will not require a paper submission and that the filer will be deemed current until the end of the period for which the exemption is granted. Rule 202 also provides that, if the exemption was granted for only a specified period rather than indefinitely,

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[298] The information would not have to be filed in paper first, as this would be meaningless in the case of interactive data.

the filer will be deemed current up to the end of that period. If the filer does not electronically submit the interactive data by the end of that period, from the next business day forward the filer will not be deemed current until it does electronically submit the interactive data. Similarly, we are revising Rule 202 to provide an essentially mirror-image exemption from the new requirement for an issuer that has a corporate Web site to post the interactive data on its Web site.

A few commenters generally supported the proposed consequences for late submissions and Web site postings of interactive data files,[299] but several objected.[300] Some commenters objected to all of the proposed consequences for late submissions and postings as, for example, unduly harsh in general[301] or inappropriate because the same information would be on file already in traditional format.[302] One commenter claimed that in analogous situations the Commission decided not to impose similar consequences. The commenter noted that in Release No. 34-49424,[303] the Commission decided not to impose short form eligibility or Rule 144 current public information loss for failure to provide timely certain disclosures required by Form

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[299] See, e.g., letters from CFA, E&Y, Grant Thornton, LG, and UTC.

[300] See, e.g., letters from ABA, CSG, LGI, NYCBA, SCS, Southern, and USS.

[301] See, e.g., letter from NYCBA.

[302] See, e.g., letter from CSG.

[303] Release No. 34-49424 (March 16, 2004) [69 FR 15594].

8-K.[304] The disclosures involved, however, were required by items that we stated "may require management to make rapid materiality and other judgments within the compressed Form 8-K filing timeframe" and issuers would not have been able to reestablish short form eligibility upon compliance because they would have been deemed not timely rather than not current.

We acknowledge these concerns, but in adopting the rules as proposed we believe that the consequences imposed will provide a useful compliance incentive and that commenters' concerns are mitigated somewhat by the availability of the temporary and continuing hardship exemptions and the ability of filers to reestablish their current status upon complying with their interactive data requirements.

III. PAPERWORK REDUCTION ACT

A. Background

The amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995, or PRA.[305] The purpose of the amendments is to make financial information easier for investors to analyze and to assist issuers in automating regulatory filings and business information processing. We published a request for comment on the collection of information requirements in the proposing release, and submitted a request to the

304 See letter from ABA. This commenter also pointed out that in Release No. 34–46464 (Apr. 8, 2003) [67 FR 58480], Release No. 34–46464A (Sept. 5, 2003) [67 FR 17880] the Commission stated that it considered making Web site posting of reports a condition to short form eligibility but concluded such an approach would be overly burdensome.

305 44 U.S.C. 3501 et seq.

Office of Management and Budget (OMB), for review in accordance with the PRA.[306] OMB responded that it will not act on the request until the Commission supplements the request at the adopting stage with a discussion that includes the Commission's response to comments received on the proposed rules. Our new estimates that take into account variations between what we proposed and what we are adopting reflect a burden that is not significantly different than the estimates from the proposing release. When we receive OMB clearance, we will publish notice in the Federal Register. An agency may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid OMB control number.

[306] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

The title for the new collection of information the amendments will establish is "Interactive Data" (OMB Control No. 3235-0645). This collection of information relates to already existing regulations and forms adopted under the Securities Act and the Exchange Act that set forth financial disclosure requirements for registration statements as well as periodic, current and transition reports and Forms 6-K. The amendments will require issuers to submit specified financial information to the Commission and post it on their corporate Web sites, if any, in interactive data form. The specified financial information already is and will continue to be required to be submitted to the Commission in traditional format under existing registration statement as well as periodic, current, and transition report and Form 6-K requirements. Compliance with the amendments will be mandatory according to the phase-in schedule previously described.[307] Issuers not yet phased-in, however, could comply voluntarily with the amendments when the appropriate taxonomies are supported by EDGAR. The information required to be submitted would not be kept confidential by the Commission.

B. Reporting and Cost Burden Estimates

1. Registration Statement and Periodic Reporting

Form S-1 (OMB Control No. 3235-0065), Form S-3 (OMB Control No. 3235-0073), Form S-4 (OMB Control No. 3235-0324), and Form S-11 (OMB Control No. 3235-0067) prescribe information that a filer must disclose to register certain offers and sales of securities

[307] See Part II.B.

under the Securities Act. Form F-1 (OMB Control No. 3235-0258), Form F-3 (OMB Control No. 3235-0256),Form F-4 (OMB Control No. 3235-0325), Form F-9 (OMB Control No 3235-0377), and F-10 (OMB Control No. 3235-0380) prescribe information that a foreign private issuer must disclose to register certain offers and sales of securities under the Securities Act. Form 10-K (OMB Control No. 3235-0063) prescribes information that a filer must disclose annually to the market about its business. Form 10-Q (OMB Control No. 3235-0070) prescribes information that a filer must disclose quarterly to the market about its business. Form 10 (OMB No. 3235-0064) prescribes information that a filer must disclose when registering a class of securities pursuant to the Exchange Act. Form 8-K (OMB No. 3235-0060) prescribes information an issuer must disclose to the market upon the occurrence of certain specified events and enables an issuer to disclose other information voluntarily. Form 20-F (OMB Control No. 3235-0288) and Form 40-F (OMB No. 3235-0381) are used by a foreign private issuer both to register a class of securities under the Exchange Act as well as to provide its annual report required under the Exchange Act. Form 6-K (OMB No. 3235-0116) prescribes information that a foreign private issuer must disclose regarding certain specified changes to its business and securities pursuant to the Exchange Act and enables an issuer to disclose other information voluntarily.

As previously noted, we are adopting the amendments substantially as proposed. We expect the variations between what we proposed and what we adopted to lessen the collection of information burden, even after accounting for the amendments requiring companies to submit interactive data for financial statements contained in additional forms - Securities Act registration statements on Forms F-9 and F-10, periodic reports on Forms 40-F and current reports on Forms 8-K and reports on Forms 6-K that contain updated financial statements that have been revised to reflect a subsequent event rather than the correction of an error.

While we are adopting the proposed requirement to tag separately each amount within a footnote (i.e., monetary value, percentage, and number), in contrast to the proposals, we will permit, but not require, filers to tag, to the extent they choose, each narrative disclosure. As a result, the cost estimates for detailed tagging in the adopting release are reduced by 30%, to 70 hours for the first filing, and 35 hours for subsequent filings. Permitting rather than requiring filers to tag each narrative footnote disclosure contributes significantly to lessening the estimated collection of information burden.[308]

As noted above, in contrast to the proposals, we are adopting amendments requiring companies to submit interactive data for financial statements contained in additional forms - Securities Act registration statements on Forms F-9 and F-10, periodic reports on Forms 40-F and current reports on Forms 8-K and reports on Forms 6-K that contain updated financial

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308 The other factor that contributes significantly to lessening the estimated collection of information burden is the reduction in the estimated number of filers subject to the interactive data requirements due to the elimination of issuers of asset-backed securities. Such issuers inadvertently were included in the estimate made in connection with the proposed rules.

statements that have been revised to reflect a subsequent event rather than the correction of an error. The amendments expanding the forms subject to the interactive data requirements tend to increase the estimated collection of information burden but this increase is more than offset by the factors that tend to decrease the collection of information burden.

We expect the following variations from the proposal will not affect the collection of information burden in more than a negligible and non-quantifiable way.

- The amendments will require that interactive data be submitted with a Securities Act registration statement filing only after a price or price-range has been determined and any later time when the financial statements are changed rather than, as proposed, requiring interactive data submissions with each filing.
- The timing of the required Web site posting has been eased. A filer must post the interactive data exhibit on its corporate Web site not later than the end of the calendar day it submitted or was required to submit the interactive data exhibit, whichever is earlier. As proposed, Web site posting would have been required by the end of the business rather than calendar day.
- Interactive data will be required to be posted for at least 12 months on an issuer's Web site. The proposing release did not specify this, but commenters requested clarification.

The information required by the new collection of information we are adopting, will correspond to specified financial information now required by these forms and will be required to appear in exhibits to these forms and on filers' corporate Web sites. The compliance burden estimates for the collection of information are based on the phase-in, beginning with approximately 500 large accelerated filers subject to the rules in the first year, followed by approximately 1,000 more filers in year two and approximately 8,700 more filers in year three. These numbers are estimated using the public float measured on the last day of the second quarter following the company's most recent fiscal year end – the same date used to determine a filer's accelerate filer status. The proposing release estimated a larger number of filers being phased in, including 1,300 in year two and 10,200 in year three. In those estimates, issuers of asset-backed securities, who annually file a Form 10-K, were included. Those issuers, however, typically are not required to and do not include their financial statements in Forms 10-K, and, as a result they would not be required to provide interactive data files under the proposed rules Consequently, they were removed from the updated estimate reported here.

Based on estimates from the voluntary filer participant questionnaire results, we estimate that interactive data filers would incur the following average

- Internal burden hours to tag the face financials:
    - 125 hours for the first filing under the requirements; and
    - 17 hours for each subsequent filing.
- Out-of-pocket cost for software and filing agent services: $6140 for each filing.

Based on qualitative assessments of time and modifications to the proposed level four detailed tagging requirements that eliminate required tagging of the narrative, we estimate that interactive data filers would incur the following average internal burden hours:

- Footnotes
  - 7 hours to block tag for each filing made during the first year under the requirements;
  - 70 hours to detail tag for the first filing made in the second year under the requirements; and
  - 35 hours to detail tag for each subsequent filing.
- Schedules
  - 1 hour to block tag for each filing made during the first year under the requirements;
  - 7 hours to detail tag for the first filing made in the second year under the requirements; and
  - 3.5 hours to detail tag for each subsequent filing.
- Web site Posting: 4 hours to post all interactive data submissions made during each year.

In the proposing release, the number of hours to detail tag the footnotes in the second year of the requirements was estimated at 100 hours for the first filing, and 50 for subsequent filings.' Several commenters provided alternative estimates. For example, one commenter[309] suggested that detailed tagging initially would require 80 hours of time, while another commenter indicated that 40 hours would be required on an ongoing basis.[310] Although both of these estimates are below our estimate, other commenters suggested that the time required for detailed tagging of the footnotes would be hundreds of hours,[311] three to four times higher than our estimate,[312] and an order of magnitude higher than our estimate.[313]

One of the considerations responsible for the wide variation in predicted time for detailed tagging was the proposed requirement to tag the narrative portion of the footnote. Unlike the discrete numerical values in the face financials that are well-defined and easy to quantify, the narrative portion of the footnotes provides a higher degree of variability in the number and structure of reported items. While we are adopting the proposed requirement to tag separately each amount within a footnote (i.e., monetary value, percentage, and number), we will permit, but not require, filers to tag, to the extent they choose, each narrative disclosure. As a result, the cost estimates for detailed tagging in the adopting release are reduced by 30%, to 70 hours for

[309] See letter from FirstEnergy. It is unclear whether this commenter believed that detailed tagging would require 80 hours on an ongoing basis.

[310] See letter from National City.

[311] See letter from Intel.

[312] See letter from IBM.

[313] See letter from Constellation Energy.

the first filing, and 35 hours for subsequent filings. Nevertheless, it is reasonable to assume that many filers, particularly the largest filers with the most complex filings, may require more than 70 hours to comply with the detailed tagging requirement. It is also reasonable to assume that many filers will require significantly less time than 70 hours, and 70 hours seems to fall within the range suggested by commenters and what is anticipated by Commission staff. We believe that the proposed requirement to tag each narrative disclosure within a footnote that, as adopted, will be optional, probably was a significant component of the higher estimates provided by commenters. As discussed in greater detail above, a significant number of commenters objected, in particular, to the proposed detailed footnote tagging requirement and several of those commenters argued that detailed footnote tagging would require significant effort by the issuer.[314]

Based on the number of filers we expect to be phased in each of the first three years under the requirements, the number of filings that we expect those filers to make that would require interactive data[315] and the internal burden hour and out-of-pocket cost estimates described, we estimate that the average yearly burden of the requirements over the first three years would be 916,846 internal hours per year and $110.6 million in out-of-pocket expenses for

[314] See Part II.B.3.a.

[315] We include in the number of filings that would require interactive data both initial filings and amended filings but we estimate that the burden incurred in connection with an amended filing would be one half the burden that would be incurred if the amended filing were an initial filing.

software and filing agent services per year and would be incurred by an average of 4,055 filers for an average yearly burden per filer of 226.1 internal hours and $27,300 in out-of-pocket expenses. This estimate reflects a reduction in average yearly burden compared to the proposing release, where we estimated $1,164,690 internal hours per year and $129 million out-of-pocket expenses per year. This reduction is in part attributed to a smaller number of filers due to the elimination of issuers of asset-backed securities that inadvertently were included in the estimate made in connection with the proposed rules, and in part due to a lower estimate for detailed tagging due to making optional the proposed requirement to detail tag the narrative disclosures in footnotes. Together, these cost reductions outweighed the increased cost of requiring that interactive data be submitted for the financial statements in additional forms.

By the fifth year under the requirements, filers generally will have been subject to the requirements for at least two years. As a result, filers generally would incur burdens applicable to interactive data filings made after the first filing in which the filer detail tagged footnotes and schedules. Consequently, we estimate that in the fifth year under the requirements, the burden on all filers would be 2,571,167 internal hours and $284 million in out-of-pocket expenses and would be incurred by 10,229 filers for an average burden per filer of 251 internal hours and $27,800 in out-of-pocket expenses.[316] The higher average burden reported for year five relative

[316] We provide an estimate of the burden in the fifth year under the new requirements because we believe the burden in the fifth year may help indicate what the burden would be under the new requirements on an ongoing basis.

to the average from years one through three reflects the completed phase-in of all filers and all requirements, including detailed tagging, by that time.

2. Regulation S-K and Regulation S-T

Regulation S-K (OMB Control No. 3235-0071) specifies information that a registrant must provide in filings under both the Securities Act and the Exchange Act. Regulation S-T (OMB Control No. 3235-0424) specifies the requirements that govern the electronic submission of documents. The changes to these items that we are adopting will add and revise rules under Regulations S-K and S-T. The additional collection of information burden that will result from these changes, however, are included in the burden estimate for the new collection of information "Interactive Data." The rules in Regulations S-K and S-T do not impose any separate burden. We assign one burden hour each to Regulations S-K and S-T for administrative convenience to reflect the fact that these regulations do not impose any direct burden on companies.

C. Comments on Collection of Information Burden

We solicited comments in the proposing release on the PRA estimates we provided there. One commenter addressed the PRA directly, while others commented generally on the time and cost burden of the amendments. The commenter that addressed the PRA directly stated that our PRA cost estimates appeared low and that our estimates understated software and non-software costs such as planning and ongoing quality assurance.[317] As discussed in detail above, other commenters provided their own estimates of the amount of time it would take to tag financial statements and footnotes.[318]

Some commenters who opposed the amendments generally asserted that interactive data would not improve the usefulness of financial information to analysts or investors[319] or that the Commission underestimated the complexity or cost of compliance in general[320] and implementing interactive data would add significant costs to purchase software, and pay for assistance and annual maintenance fees for that software and that the costs of using interactive data outweighed the benefits.[321]

In contrast, some commenters that supported the required submission of interactive data believed it would improve the usefulness of financial information to companies and investors, and that mandated interactive data use would provide the incentives to drive sufficient investment in software to enable widespread adoption of interactive data.[322] Also in contrast, commenters that provide interactive data services stated that issuers would need to expend only

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[317] See letter from Credit Suisse.

[318] See Part III.B.1.

[319] See letters from EEC; EuropeanIssuers, and FISD.

[320] See, for example, letters from CAQ, E&Y, FPL, Intel and SCS.

[321] See letter from FPL.

[322] See, e.g., letters from ABC, AICPA, National City, NYSSCPA, and UTC.

modest cost and effort to comply with the requirements.[323] One commenter stated that it expected that costs would fall quickly, especially for small companies, as interactive data became part of standard corporate accounting software packages.[324] Another commenter stated that, based on its experience in the voluntary program, costs would fall significantly for subsequent submissions.[325]

We acknowledge the concerns some commenters hold regarding usefulness and cost but believe that interactive data have the potential to increase the speed, accuracy and usability of financial disclosure, and eventually reduce costs and that the phase-in schedule and the grace periods will provide issuers the time to learn more cost-effective ways to comply. We also believe that the third year phase-in for smaller reporting companies will permit them to learn from the experience of the earlier filers. Further, as noted previously, we will be monitoring the experiences of issuers during the phase-in periods to assess commenters' concerns.

IV. COST-BENEFIT ANALYSIS

A. Benefits

Requiring issuers to file their financial statement information using the interactive data format would enable investors, analysts, and the Commission staff to capture and analyze that

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323 See letters from ECI, EDGARFilings and UBMatrix.

324 See letter from Angel.

325 See letter from Pepsico.

information more quickly and at a lower cost than is possible using the same financial information provided in a static format.[326] Even though the new regime does not require any new information to be disclosed or reported, certain benefits may accrue when issuers use an interactive data format to provide their financial reports. These include the following.

1. More Financial Information Available to Investors

Interactive data reporting could increase the amount of financial data available to investors in at least three ways. First, there is likely to be an increase in coverage of smaller reporting companies by commercially available products that provide corporate financial data. Second, the level of financial data available in electronic format by these and other services will likely increase as a result of interactive data tagging. Finally, there is likely to be an increase in the number of suppliers of financial services products because of requiring companies to provide interactive data. As a result, many smaller filers will have greater investor awareness because of interactive data reporting, and investors will have more financial data readily available in machine-readable format to consider for all filers.

At present, many small companies are not included in commercially available products that provide corporate financial data, possibly due to high data collection costs relative to the value of providing coverage. For example, two commonly used financial information vendors

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[326] See Part I.

cover approximately 70% of Commission filers.[327] For the large number of firms whose financial statements are not currently reported in these databases, their absence may reduce the likelihood that they receive coverage by financial analysts who use commercially available products to assess issuer performance. Consequently, if interactive data reporting increases coverage of smaller companies by commercially available financial information products, and this increases their exposure to analysts and investors, then lower search costs for capital could result. In other words, smaller companies could realize a lower cost of capital, or less costly financing.

While an increase in coverage could occur for some issuers, it is possible that less than full coverage will remain in more sophisticated products that provide analysis or reporting items beyond basic financial information. This conclusion is based on an assumption that many commercially available product offerings provide information beyond what is reported in basic financial information, and the costs of providing this additional information for every company may make 100% coverage prohibitive. In particular, the smallest issuers may not offer sufficient market capitalization to make investment worthwhile to larger investors, for whom these commercial products are primarily designed.

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[327] Compustat and Thomson One Banker are two widely used, fee-based vendors of corporate financial data that is formatted for interactive data use. This analysis was performed by matching the unique Commission issued Central Index Key (CIK) numbers from all Forms 10-K, 10-KSB, 20-F, and 40-F filed in calendar year 2007, but not including issuers of asset backed securities within Standard Industrial Classification (SIC) code 6189, to the universe of companies covered by both Standard and Poor's Compustat and Thomson One Banker.

It is also possible that information quality in financial markets could be higher if interactive data reporting were required than if not, leading to more efficient capital allocation. Since financial tagging will include footnotes and supplemental tables, as well as the base financials reported in the standard tables, it is likely that as a result of interactive data tagging, there will be more information available to investors in a machine-readable format. That is, information not currently collected on a broad scale by data aggregators because of the costs of manual key entry, particularly data found in the footnotes and supplemental tables, will be available to investors in a tagged, machine-readable format. With more information readily available to investors on all filers, they may be able to better distinguish the merits of various investment choices, thereby facilitating capital flow into the favored investment prospects. This outcome is the main tenet of improved market efficiency, whereby providing more widespread access to information concerning the value of a financial asset, such as a company's shares, results in better market pricing. Consequently, reducing the costs of accessing, collecting and analyzing information about the value of a financial asset facilitates this end.

Finally, it is possible that requiring companies to provide interactive data could improve the quality of financial information available to end users, and help spur interactive data-related innovation in the supply of financial services products, resulting from a potential increased competition among suppliers of such products due to lower entry barriers as a result of lower data collection costs.

2. Less Costly and More Timely Financial Information

It is likely that the new interactive data requirements will lower the cost of collecting corporate financial data in a machine-readable format and allow it to be analyzed by investors and other end-users more quickly than without interactive data. At present, financial information is made available to investors in text formatted documents that require manual key-entry of the data into a format that allows statistical analysis and aggregation. Investors seeking broad financial coverage of companies must either spend considerable time manually collecting the data, or subscribe to a financial service provider that specializes in this data aggregation process, but passes on the expense of the data collection effort.

Requiring companies to report interactive data should lower both the time and expense for investors to access this data. Since company financial data will be tagged and immediately downloadable into a larger, more comprehensive database that includes other filers, there will be no need for manual key entry of the data, eliminating this expense. Moreover, with this manual key entry effort no longer necessary, the delay between when the financial data are first filed and when the data is available in machine-readable format will reduce substantially. For instance, one unpublished study reports that as recently as 2004, the average time required for one large data aggregator to make financial data available to investors was 10.8 days.[328] With interactive data reporting, company financials can be integrated into subscriber databases within a matter of hours or minutes. As a result of having data made available more quickly to investors and other

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[328] Julia D'Souza, K. Ramesh, and M. Shen, "The interdependence between institutional investor stock ownership and information dissemination by capital market data aggregators," Michigan State University working paper, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1010834.

end-users, newly revealed information can be more quickly priced into the market by a larger number of investors, consistent with tenets of improved market efficiency.

If interactive data serves to lower the data aggregation costs as expected, then it is further expected that smaller investors will have greater access to financial data than before. In particular, many investors that had neither the time nor financial resources to procure broadly aggregated financial data prior to interactive data will have lower cost access than before interactive data. Lower data aggregation costs will allow investors to either aggregate the data on their own, or purchase it at a lower cost than what would be required prior to interactive data. Hence, smaller investors will have fewer informational barriers that separate them from larger investors with greater financial resources.

It is also likely that a filer that uses a standardized interactive data format at earlier stages of its reporting cycle also may increase the usability of its internal financial information. For example, filers that use interactive data may be able to consolidate enterprise financial information more quickly and potentially more reliably across operating units with different accounting systems.[329] There has been a growing development of software products to assist filers to tag their financial statements using interactive data helping make interactive data increasingly useful.[330]

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[329] However, we recognize that at the outset, filers would most likely prepare their interactive data as an additional step after their financial statements have been prepared.

[330] Press Release No. 2007-253 (Dec. 5, 2007).

Interactive data also could provide a significant opportunity for issuers to automate their regulatory filings and business information processing, with the potential to increase the speed, accuracy, and usability of financial disclosure. This reporting regime may in turn reduce filing and processing costs.

3. Fewer Errors

Because a substantial portion of each financial report makes use of the same information, a filer that uses a standardized interactive data format at earlier stages of its reporting cycle may also increase the accuracy of its financial disclosure by reducing the need for repetitive data entry that could contribute human error and enhancing the ability of a filer's in-house financial professionals to identify and correct errors in the issuer's registration statements and periodic reports filed in traditional electronic format. It is also possible that there will be fewer errors in the aggregated financial data used by investors since manual key entry of data will no longer be required by either the investor or a data aggregating service.

4. Increased Comparability and Interpretation of Financial Data

Another potential information consequence of the new requirements may be changes to the precision and comparability of the information disseminated by data service providers since the interactive data requirements would shift the source of data formatting that allows aggregation and facilitates comparison and analysis from end-users to issuers submitting interactive data. At present, data service providers manually key financial information into a format that allows aggregation. As a result, the data service provider makes interpretive decisions on how to aggregate reported financial items so that they can be compared across all companies. Consequently, when a subscriber of the commercial product offered by a data service provider uses this aggregated data, it can expect consistent interpretation of the reported financial items. In contrast, a requirement for issuers to submit interactive data information would require the issuers to independently decide within the confines of applicable requirements which financial "tag" best describes each financial item – lessening the amount of interpretation required by data service providers or end-users of the data. Once a standard tag is chosen, comparison to other companies is straightforward. However, since companies have some discretion in how to select tags, and can extend the taxonomy (create new tags) when an appropriate tag does not exist, unique interpretations by each company could result in reporting differences from what current data service providers and other end-users would have chosen. This view suggests that the issuer-submitted information disseminated by data service providers may be, on the one hand, less comparable because they have not normalized it across issuers but, on the other hand, more accurate because the risk of human error in the manual keying and interpretation of filed information would be eliminated and more precise because it will reflect decisions by the issuers themselves. Replicating prior methods would still be possible, however, because issuers would continue to be required to file financial information in traditional format. As a result, nothing would prohibit data service providers from continuing to provide data in the same manner that they did before. Nonetheless, interactive data benefits could diminish if other reporting formats are required for clarification in data aggregation.

B. Costs

The primary cost of the rulemaking is the cost of filers' implementation of the rule, which includes the costs of submitting and posting interactive data. We discuss this cost element extensively below. In addition, because the rule allows an increase in the flow of financial information being reported directly to analysts and investors, there will be a cost of learning on the part of the investors in using and analyzing financial information at the interactive data level. Finally, because interactive data provides a standardized reporting format – a set of common tags from which filers can select – this might affect a company's ability to communicate its unique financial attributes to investors.

As for the cost of implementation of the rule, based on currently available data, we estimate the average direct costs of submitting and posting interactive data-formatted financial statements and other information for all issuers under the proposed rules would, based on certain assumptions, be as follows:

Table 1. Estimated direct costs of submitting interactive data-formatted financial statements and other information

	First submission with block-text footnotes & schedules	Subsequent submission with block-text footnotes & schedules	First submission with detailed footnotes & schedules	Subsequent submission with detailed footnotes & schedules
Preparation face financials[331]	$31,370	$4,310	$4,310	$4,310
Preparation footnotes[332]	$1,750	$1,750	$17,500	$8,750
Preparation schedules	$250	$250	$1,750	$875
Software and filing agent services[333]	$6,140	$6,140	$6,140	$6,140
Web site posting[334]	$1,000	$1,000	$1,000	$1,000
Total cost	$40,510	$13,450	$30,700	$21,075
Upper bound	$82,220	$21,340	$60,150	$37,940

[331] Estimates based on voluntary filer program questionnaire responses, excluding participants with an interactive data-related business interest. These data suggest that the time required for tagging the face financials decreases by approximately 85% between the first and second submissions, from 125.47 hours to 17.25 hours, numbers which are rounded to 125 and 17 for PRA calculations. A $250 wage rate is assumed for all preparation cost estimates.

[332] The costs associated with block-tagging of footnotes and schedules are assumed to remain constant in subsequent filings. In contrast, anticipated learning benefits from more complicated detailed tagging of footnotes and schedules are assumed to result in a 50% reduction in cost for subsequent filings.

[333] Software licensing and the use of a print agent can be substitutionary – companies can choose to do one or other, or do both – and are thus aggregated.

[334] This is an annual cost, and as such, will not be incurred for subsequent filings within the same year.

The above estimates are based in part on questionnaire responses from 22 issuers that have participated in the voluntary program. Thirty-five participants were sent questionnaires, corresponding to a response rate of 63%. These responses provided detail on the projected costs of preparing the face financials and for purchasing software or related filing agent services.[335] The estimated total cost reported in Table 1 reflects expenditures on interactive data-related software, consulting or filing agent services used, and the market rate for all internal labor hours spent (including training) to prepare, review and submit the first interactive data format information face financial statements. The major assumptions used for this analysis are as follows.

- Labor cost is estimated at $250 per hour, commensurate with the wage rate of an external accountant;[336]
- Voluntary program participants reported a 85% average reduction in time required to prepare face financials from the first to second filing;

[335] Voluntary program participants were not required to tag financial statement footnotes or schedules related to the financial statements except that registered management investment company participants were required to tag one specified schedule. Similarly, voluntary program participants were not required to post on their corporate Web sites, if any, the interactive data information they submitted. Consequently, the costs of requirements to tag financial statement footnotes and schedules related to financial statements and post interactive data information are not derived from the voluntary program participant questionnaire responses or discussed in our analysis of those responses.

[336] These estimates are from the Securities Industry and Financial Markets Association's Management and Professional Earnings in the Securities Industry 2007, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

- Block tagging of footnotes is estimated at 7 hours for the first filing, with a 50% reduction in time for subsequent filings; and.
- Detailed tagging of footnotes is estimated at 70 hours for the first filing; with a 50%. reduction in time for the subsequent filings.

1. Potential Variability in the Cost estimate

We report an upper bound for the estimated total cost based on (1) the variation in responses from the voluntary program participants and the likelihood of sampling error – respondents represent approximately 0.21% of all issuers that ultimately would be required to submit interactive data[337] – and (2) the likelihood of sample selection bias due to non random participation by filers in the voluntary filing program. In particular, we estimate that:

- Average cost estimates increase by 20% after removing voluntary program participants in an interactive data-related business.
- Due to sampling error,[338] there is a 1% chance that the true costs are underestimated by up to 80%.

[337] This is based on 10,672 domestic and foreign issuers that filed an annual report in calendar year 2007. Under our proposed rules, not all foreign private issuers would be required to submit interactive data; only those foreign private issuers that prepare their financial statements in accordance with U.S. GAAP or IFRS as issued by the IASB would be required to submit interactive data. Foreign private issuers that report in accordance with other structures and reconcile to U.S. GAAP would not be required to submit interactive data.

[338] In general, sampling error is the error that arises as a function of sampling in general and the sample chosen in particular.

The upper bound reported in Table 1 is $82,220 for the first filing compared to the average of $40,510. This upper bound is calculated based on the 1% likelihood that costs are underestimated by 80%, and after removing responses from five participants in an interactive data-related business. These voluntary filer program participants, including filing agents, financial services providers, and other consulting agents, may have incentives and skill sets unrepresentative of the average issuer that may cause their costs to depart from the likely submission cost of the average issuer when interactive data is required.

The costs in Table 1 do not reflect the following factors that could also affect the total cost of compliance.

- Smaller financial issuers appear to have less complex financials and labor costs that tend to be 20-30% lower than for other issuers to submit interactive data information.
- There also is some evidence to suggest that the smallest (non-accelerated) issuers might have submission costs or compliance difficulties in excess of other issuers.
- The lists of tags used to prepare the face financial statements by those issuers that responded to the questionnaire for the voluntary program have been updated for the required program.[339]

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[339] For example, the related list of tags would differ between the voluntary and proposed required program. When we adopted the voluntary program, the list of tags for U.S. GAAP financial statement reporting contained approximately 4,000 data elements. The list of tags released on April 28, 2008 contains approximately 13,000 data elements, with the most significant additions relating to the development of elements for standard U.S. GAAP footnote disclosure.

The voluntary program questionnaire evidence is based on responses of predominantly large issuers, and their cost experience may not be representative of the smaller issuers or non-participating larger issuers. In particular, voluntary program participants that responded to the questionnaire are found among the largest of all issuers, with more than 88% considered large accelerated filers (measured as greater than $700 million in public float). In contrast, only 1,529 of 10,229 filers (15%) expected to be subject to the rule were considered large accelerated filers in their fiscal year-end 2007.

A size bias is plausible, since there are reasons to believe that the reported submission costs vary with the size of the issuer. For instance, larger issuers might have lower interactive data submission costs than smaller issuers, since they have a larger pool of internal resources to draw from, allowing them to more efficiently allocate available skill sets from their labor pools to implement interactive data reporting technology. Moreover, larger organizations might have greater excess capacity in their internal labor pool such that they are better able to absorb the short-term labor needs of "learning" interactive data. If so, the effect of sample selection in this instance may be to underreport the interactive data submission costs for smaller issuers.

Alternatively, smaller issuers could have lower submission costs than larger issuers if their operations are less complex. This reasoning suggests that simpler business operations lead to simpler financial statements, requiring less effort to tag and submit using interactive data. Hence, any reduction in available resources to allocate to interactive data submission may be offset by lesser demand for resources. This view suggests a trade-off in submission costs as issuers become smaller, and as a typical result, less complex.

The balance of evidence suggests that smaller filers will have, on average, lower submission costs than larger filers. Although the U.S. voluntary filer program contains data predominantly on larger filers, and as a result cannot directly address this issue, evidence from the Japanese interactive data pilot program reveals a 20 to 30% reduction in the time required to comply with their first interactive data filing for the smaller filers relative to the largest filers.[340] This percent reduction is consistent with the percent reduction in U.S. filing complexity across filer size. In particular, we find that the number of financial statement items reported in periodic reports falls by 15 to 20% for the smallest filers compared to largest filers. Hence, the reduction in time required in the Japanese study is broadly consistent with the filing complexity – measured by the number of filing elements – among U.S. filers.

Nevertheless, there remain concerns for the smallest filers. The Japanese study reveals that compliance costs begin to increase as filer size goes from smaller to smallest, although the costs are not more than those of the largest filers – costs for the smallest Japanese filers are roughly 15% lower than the largest filers, but about 25% higher than the lowest cost smaller filers. Moreover, the smallest Japanese filers had the highest likelihood of delayed filing in their first submission: 25% did not file by the mandated date compared to 5% for the largest filers.

[340] Starting in April 2008, Japanese filers were required to report financial statements with their Financial Services Agency (JFSA) using interactive data technology. Before this requirement, 1,233 Japanese companies participated in a pilot program; 768 participants described their interactive data submission experience through a JFSA survey. For our previous fuller discussion of the JFSA survey, see the proposing release.

These risk factors motivate a phase-in schedule that allows smaller filers to lag larger filers in mandated reporting compliance.

2. Cost Estimates for Footnote Tagging and for Software

While the required time to prepare face financials is estimated based on responses from the voluntary filer participants, the same is not true for tagging of footnotes. At the time of the questionnaire, footnote tagging was not prevalent among voluntary filers and a cost estimate from their experience could not be obtained. In the proposing release, block tagging was estimated at seven hours for the first filing, and detailed tagging estimated at 100 hours. In both cases, a 50% reduction in preparation time was assumed between the first and subsequent filings, which is a more conservative learning rate than what was observed for tagging of face financial (85% reduction). In the adopting release, detailed tagging of the narrative is no longer required, and as a result, the cost estimates for detailed tagging in the adopting release are reduced by 30%, to 70 hours for the first filing, and 35 hours for subsequent filings. Nevertheless, it is reasonable to assume that many filers, particularly the largest filers with the most complex filings, may require more than 70 hours to comply with the detailed tagging requirement. It is also reasonable to assume that many filers will require significantly less time than 70 hours, and 70 hours seems to fall within the range suggested by commenters and what is anticipated by Commission staff. As discussed in more detail above, we believe that the proposed requirement to tag each narrative disclosure within a footnote that, as adopted, will be optional, probably was a significant component of the higher estimates provided by commenters.[341]

The software costs assumed in the cost estimate also include anticipated print agent and filing service fees. The experience of voluntary filer participants suggests that many filers have not yet determined the optimal compliance method, and several pursued simultaneous approaches. So while some participants prepared and filed their documents on their own, and others contracted the entire experience to a print agent, many pursued some combination of the two. As a result of the complexity with which filers reported their experience, we aggregated all of their software and print agent costs into one category. We estimate the total cost for software and filing agent services at $6,140 per filing.

It is possible that filers will experience a lower cost than $6,140. For instance, one service provider[342] charges a flat fee of $1,995 for both Form 10-K and Form 10-Q periodic reports. Nevertheless, some commenters were concerned about the availability and rising cost of software. For instance, one commenter reported a 65% increase in software costs from one vendor after the Commission released its interactive data proposal in May of 2008.[343] Another

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341 See Part III.B.1.

342 See letter from Rivet.

343 See letter from FPL.

commenter worried that third party vendors will not be ready in time for the proposed phase-in of the rule.[344]

Until the rule is phased in on a broad scale, it is hard to predict what equilibrium price of software, consulting, and filing agent services will prevail. The roles of each potential kind of service provider within the interactive data market are likely to develop further and are not yet clear, and there are many potential participants to consider, including the software vendors, financial reporting system providers (i.e., providers of widely used financial products), print/filing agents, and other consultants. Until the market of issuers that submit interactive data information grows substantially larger (either by requirement or by expansion of the number of volunteers), many different potential solutions are possible. For example, issuers may adopt solutions that create interactive data submissions using third party software, a so-called "bolt-on" approach, or may seek integrated solutions that enable issuers to prepare interactive data submissions from their existing financial services software. Moreover, filing agents may maintain their role as an intermediary by offering interactive data technology or other service providers may cause that role to change. Others with financial and technical expertise may participate in the technology that may yield different results.

Combining the uncertainty over the source of future interactive data services with increased demand for these services could result in a new market price that is different from what

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[344] See letter from Comcast.

is currently reported by voluntary program participants. This price could be higher if the demand for interactive data services increases (from 76 voluntary program participants at the time of the cost analysis to more than 10,000 total participants) at a faster rate than the supply for these same services. More broadly, if an interactive data requirement resulted in clients subscribing for interactive data services faster than the rate at which these services can be supplied, then prices could increase. A phase-in schedule that limits the number of participants in the first year is likely to mitigate this concern to the extent that the rate of phase-in allows interactive data service suppliers to keep pace with demand.

3. Interpretability of Standardized Tagging

Since interactive data formatting provides a standard set of tags from which companies select when they report their financial data, one potential consequence of the proposed requirements is that companies will be less able to communicate their unique financial attributes to investors. A standard set of tags helps facilitate easier comparability between companies, but this benefit might come at a cost of less precise information about a company if the selected tag is different from what the company would have labeled the information without interactive data reporting. While it is possible for a company to create an extension (a new tag) to reflect unique financial information when it is not otherwise described by a standard tag, this information will no longer be easily aggregated across other companies.

Nevertheless, the risk of interpretability of reported financial data already exists in the current data aggregation process. According to current practices, financial data service providers manually key financial information into a format that allows aggregation so that they can resell it to investors. As a result, the data service provider makes interpretive decisions on how to aggregate reported financial items so that they can be compared across all companies. This is done so that a subscriber of the commercial product offered by a data service provider can expect consistent interpretation of the reported financial items, allowing comparability in the same way that it is intended with interactive data. Hence, from one perspective, adoption of interactive data will shift the burden of making the interpretive decision on how to label a financial item from financial service providers to the companies making the filings. To the extent that the company is better able to classify financial data for comparability to other companies through interactive data tagging than a financial data service provider who manually keys and classifies financial data from standard paper based filings, then interpretability of reported financial data should not worsen with adoption of interactive data reporting.

4. Corporate Web Site Posting

Filers must also post their interactive data files to their corporate Web site if they have one. The direct cost estimate of doing so is four hours of time, or $1,000. In relation to the other costs of interactive data adoption, this cost is low. Although the estimated cost of mandatory posting is low compared to other costs of interactive data compliance and it is possible that many companies would post this data even if it were not mandatory, it is difficult to quantify specific benefits of mandatory posting beyond the benefit of having this same document posted on the

Commission's Web site. Nevertheless, potential benefits of required corporate Web site posting include the following:

- encouraging widespread accessibility and dissemination of interactive data, promoting its awareness and use;
- making it easier and faster for investors to collect information on a particular filer required to post, particularly if the investor is already searching the Web site;
- transferring reliability costs of data availability to the public companies by reducing the likelihood that investors cannot access the data through the Commission's Web site, due to down-time for maintenance or due to increased network traffic;
- enhancing access to corporate financial data by Web crawlers searching for such information that face access restrictions on EDGAR; and
- providing incentive for corporations to add content or enhance their Web site improving the investor experience.

Although there is potential to realize each of these stated benefits, there are also reasons why they may not manifest. The most likely reason that benefits will not accrue to investors from mandatory Web site posting is that a key feature of interactive data that makes them valuable to investors is the ability to aggregate financial data across companies. Since filers will use common tags that allow aggregation of firm financials, company performance can be compared in ways that are far less costly and time consuming than doing so without interactive data. Facilitating this comparison, however, is expected to be less likely to occur at a specific corporate Web site than it is at a third party Web site that provides a wide range of companies to analyze. Since companies are not required to post interactive data for other filers, this leaves investors two options for assembling aggregated financial data. The investor can obtain the data from separate visits to each corporate Web site of interest, or the investor can visit a third party Web site – such as EDGAR or commercial sources – and obtain the necessary data from a single source. The latter option is far more efficient, not only because of time savings, but also because central depositories of financial information provide access to companies for which an investor might not otherwise know to look. In other words, a filer may only know to investigate a company by having it reside in a location adjacent to where the investor is already searching. For instance, a feature of many third party information forums is to provide, without prompting, a set of comparable firms to the firm that an investor is currently researching using the provider's tools. There is no duty for a company to provide on its Web site a similar set of comparables for a visiting investor.

As a result, it is likely that individual corporate Web site posting of data could potentially offer a faster source of financial data to an investor only if the investor is not interested in broad data aggregation. If an investor is interested in interactive data for several companies, then identifying the unique Web address for each company, and locating where on the Web site the interactive data resides, will consume far more of an investor's time than going to a central location with only a single Web address and a single Web site design to navigate. If, on the other hand, an investor is interested only in the information from a specific company, then interactive data offer fewer benefits to the investor relative to other file formats, such as HTML, that offer data in a visually organized manner.

Similarly, data aggregators and Web crawling tools that search for corporate financial data will not necessarily benefit from mandatory corporate Web site posting of interactive data.

For the same reason that an individual investor will find it easier to visit a central information depository for information rather than each individual corporate Web site, so will data aggregators and Web crawlers. Programming a Web crawling tool to search thousands of Web sites whose addresses and layouts are continually changing is more complex than doing the same for a single Web site. Moreover, investors face similar risks at corporate Web sites of restricted Web crawler activity, the Web site going down for maintenance, and slow connections due to high network traffic as they would at a central information depository such as EDGAR. This is particularly true to the extent that smaller corporate filers have fewer resources to maintain their Web site than the Commission or other third party sources of financial information.

V. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act[345] 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. Furthermore, Section 2(b)[346] of the Securities Act, Section 3(f)[347] of the Exchange Act, and Section 2(c)[348] of

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[345] 15 U.S.C. 78w(a)(2).

[346] 15 U.S.C. 77b(b).

[347] 15 U.S.C. 78c(f).

[348] 15 U.S.C. 80a-2(c).

the Investment Company Act require us, when engaging in rulemaking where we are required 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.

The amendments requiring issuers to submit interactive data to the Commission and post it on their corporate Web sites are intended to make financial information easier for investors to analyze. In particular, we believe that the amendments will enable investors and others to search and analyze the financial information dynamically; facilitate comparison of financial and business performance across issuers, reporting periods and industries; and, possibly, provide a significant opportunity to automate regulatory filings and business information processing with the potential to increase the speed, accuracy, and usability of financial disclosure. Further, we believe that the amendments may lead to more efficient capital formation and allocation. As discussed in detail above, we suggest that smaller public companies could benefit from increased analyst and investor coverage if interactive data increases the availability, or reduces the cost of collecting and analyzing, corporate financial data. As a result, interactive data may reduce some of the information barriers that make it costly for companies to find appropriate sources of external finance, thus lowering their cost of capital and increasing the efficiency of capital formation.

We understand that private sector businesses such as those that access financial information and aggregate, analyze, compare or convert it into interactive format have business models and, as a result, competitive strategies that the new interactive data requirements might affect. Since interactive data technology is designed to remove an informational barrier, business models within the financial services industry that are currently adapted to traditional format document reporting may change, with possible consequences for the revenue stream of current product offerings due to the competitive effects of such a change. The competitive effects may relate to changes in the accessibility of financial information to investors, the nature of the information that investors receive, and the potential from new entry or innovation in the markets through which financial reports are transmitted from filers to investors. For example, lower entry barriers that result from lower data collection costs may increase competition among suppliers of financial services products and help spur interactive data-related innovation. It is also possible, however, that, increased competition from new market entrants could reduce industry profit margins, and, as a result, the quality of financial services may suffer. For example – and illustration purposes only – assume that an Internet service company develops an interactive data-based tool that easily provides company base financial data for free to all subscribers, and it uses this product as a loss leader to increase viewership and advertising revenue. If the data provided is of the same quality as data provided through subscription to other available commercial products, then there should be no informational efficiency loss and the quality of financial data services should not be impaired. However, if the incumbent financial service providers provide a higher quality of information that improves investor interpretation beyond base financials, but they find that it is no longer profitable to produce this information as a result of subsidized products from inferior providers, then these financial data service providers may reduce the supply of higher quality information to investors.

We requested comment on whether the amendments would promote efficiency, competition, and capital formation or have an impact or burden on competition.

A few commenters expressly addressed the amendments' competitive effects. One commenter argued that the amendments would harm competition and innovation in computer operating systems because interactive data are restricted on non-Windows operating systems.[349] This commenter stated that interactive data source code was not available to the public and that there were no interactive data viewers that worked under Macintosh or Linux platforms. We have considered the commenter's views. In this regard, we note that the XBRL form of interactive data that the rules require, with appropriate software, could be used on non-Windows operating systems and seen in human-readable form through viewers that worked under Macintosh or Linux platforms. We also note that XBRL is an "open standard" format and its technological specifications are widely available to the public royalty-free at no cost.

Several commenters questioned the efficiency of interactive data. In this regard, commenters addressed the comparability of interactive data and the corporate Web site posting requirement.

Some commenters stated that interactive data would be hard for investors to use in the

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[349] See letter from Jay Starkman.

manner it was intended to be made part of the interactive data requirements because there would be a lack of comparability due to the Commission's permitting issuers to use taxonomies with thousands of standard elements and additional extensions.[350] We believe that the combination of a robust list of standard elements and the ability to add extensions where necessary, strikes an appropriate balance between comparability and specificity. We also believe that if certain extensions become common, new standard elements can be added to eliminate the need to use these extensions and, thereby, enhance comparability.

A commenter questioning the efficiency of the Web site posting requirement expressed concern about the risk of hosting delays, and the potential for errors and duplication of effort. This commenter suggested that a hyperlink to the interactive data on the Commission's Web site would be more effective and would be consistent with the current practice of some companies linking to their periodic reports on the Commission's site.[351] As noted above, we believe that corporate Web site availability of interactive data will encourage its widespread dissemination, thereby contributing to lower access costs for users. Users that prefer to access the interactive data through another source such as the Commission's Web site would be free to do so.

Commenters addressed competition in terms of the opportunity to participate in submitting interactive data and the costs imposed by the requirement to submit interactive data.

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350 See letters from Haynsworth and SavaNet.

351 See letter from IBM.

A commenter argued for the expansion of interactive data's use in order to promote competition. Specifically, this commenter suggested that issuers be permitted to submit interactive data with MJDS forms to enable MJDS issuers to avoid a competitive disadvantage that would result from the inability to submit interactive data.[352] As discussed above, the new rules generally will require issuers to submit interactive data for their MJDS forms. One commenter stated that the additional costs of the interactive data requirements would make the U.S. market less attractive to foreign issuers.[353] Another commenter recommended that foreign private issuers be excluded from the phase-in period, asserting that foreign issuers would face more difficulty due to factors such as language differences and less access to service suppliers.[354] We acknowledge these concerns about cost and effort but believe that the adopted requirements are appropriate in light of the potential interactive data have to increase the speed, accuracy and usability of financial disclosure, and eventually reduce costs.

VI. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to amendments that will require issuers to provide their financial statements to the Commission and on their corporate Web sites in interactive data format.

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[352] See letter from CP.

[353] See letter from EuropeanIssuers.

[354] See letter from CSG.

A. Reasons for, and Objectives of, the Adopted Amendments

The main purpose of the amendments is to make financial information easier for investors to analyze while assisting in automating regulatory filings and business information processing. Currently, issuers are required to file the financial statements in their registration statements, quarterly and annual reports, and transitional reports and revised or updated financial statements in their current reports on Form 8-K and reports on Form 6-K in a traditional format that provides static text-based information. We believe that providing these financial statements in interactive data format will:

- enable investors and others to search and analyze the information dynamically;
- facilitate comparison of financial and business performance across issuers, reporting periods and industries; and
- provide an opportunity to automate regulatory filings and business information processing with the potential to increase the speed, accuracy, and usability of financial disclosure.

B. Significant Issues Raised by Public Comment

The Initial Regulatory Flexibility Act Analysis appeared in the proposing release (IRFA). We requested comment on any aspect of the IRFA, including the number of small entities that may be affected by the amendments, the nature of the potential impact of the amendments on small entities, and how to quantify the impact of the amendments. We asked those submitting comments to provide empirical data supporting the extent of the impact.

One commenter, while acknowledging that the largest filers included in the first phase should be able to effectively deal with the amendments' requirements, expressed concern about the capacity of smaller filers to do so.[355] This filer suggested that the Commission thoroughly study the initial phase-in period to determine whether smaller filers will have the resources and staff to be able to comply with the requirements of the rule in the time period proposed. This filer also believed that smaller issuers with less than $50 million of public float should be able to opt out of the requirements of the amendments but voluntarily comply if they so choose. One commenter noted that the grace period following the filing of a Form 10-K offers little relief for smaller companies due to the number of filings prepared shortly thereafter. Specifically, this commenter noted that at many smaller companies, the staff responsible for the preparation of a Form 10-K immediately turn their time and attention to the preparation of the company's proxy statement after filing the Form 10-K. The commenter stated that a Form 10-Q is not followed by a similar series of reporting obligations, so a grace period following this report is consequently more helpful in assisting companies avoid excessive expense and burden.[356]

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[355] See letter from NYSSCPA.

[356] See letter from ABA.

We also note that commenters that provide interactive data services stated that issuers would need to expend only modest cost and effort to comply with the proposed requirements.[357] One commenter stated that it expected that costs would fall quickly, especially for small companies, as interactive data became part of standard corporate accounting software packages.[358] As noted throughout the release, we are sensitive to the impact of the amendments on small companies and while we recognize that requiring interactive data financial reporting will likely result in start-up expenses for such companies, these expenses may be substantially lower than those of larger filers, given that smaller filers tend to have simpler financial statements than larger companies, with fewer elements and disclosures to tag. We expect that the phase-in will foster the improvement and availability of inexpensive software. We also believe that the third year phase-in for smaller reporting companies will permit them to learn from the experience of the earlier filers and give them a longer period of time across which to spread first-year data tagging costs.

C. Small Entities Subject to the Amendments

The amendments will affect issuers that are small entities. Exchange Act Rule 0-10(a)[359] defines an issuer, other than an investment company, to be a "small business" or "small

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357 See letters from ECI, EDGARFilings and UBMatrix.

358 See letter from James J. Angel.

359 17 CFR 240.0-10(a).

organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year.[360] We estimate that there are approximately 1,100 issuers that file reports under the Exchange Act and may be considered small entities.[361] All of these issuers would become subject to the amendments in year three of the phase-in.

D. Reporting, Recordkeeping and Other Compliance Requirements

All issuers subject to the amendments will be required to submit financial information to the Commission in interactive data format and, if they have a corporate Web site, post the interactive data on their Web site. We believe that, in order to submit financial information in interactive data format, issuers in general and small entities in particular likely will need to prepare and then submit the interactive data by expending internal labor hours in connection with either or both of;

- purchasing, learning and using software packages designed to prepare financial information in interactive format; and

[360] Securities Act Rule 157(a) [17 CFR 230.157(a)] generally defines an issuer, other than an investment company, to be a "small business" or "small entity" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year and it is conducting or proposing to conduct a securities offering of $5 million or less. For purposes of our analysis of issuers other than investment companies in this Part VI of the release, however, we use the Exchange Act definition of "small business" or "small entity" because that definition includes more issuers than does the Securities Act definition and, as a result, assures that the definition we use would not itself lead to an understatement of the impact of the amendments on small entities.

[361] The estimated number of small entities that report under the Exchange Act is based on 2007 data including the Commission's internal computerized filing system and Thompson Financial's Worldscope database.

- hiring and working with a consultant or filing agent.[362]

We believe that issuers will incur relatively little cost in connection with the requirement to post the interactive data on the issuer's corporate Web site because the requirement applies only to issuers that already have a corporate Web site.[363]

E. Agency Action to Minimize the Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered several alternatives, including the following:

- establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- further clarifying, consolidating or simplifying the requirements;
- using performance rather than design standards; and
- providing an exemption from the requirements, or any part of them, for small entities.

We believe that, as to small entities, differing compliance, reporting or non-phase-in

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[362] Some issuers such as those that have participated in the voluntary program may already prepare financial information in interactive data format or already have the expertise and software to prepare financial information in interactive data format. Those issuers would incur fewer costs as a result of the new requirements. Based on our experience with the voluntary program, however, we believe that it would be unlikely that those issuers would include many small entities.

[363] The internal labor and external costs required to comply with the new rules are discussed more fully in Parts III and IV above.

timetable requirements, a partial or complete exemption from the amendments or the use of performance rather than design standards would be inappropriate because these approaches would detract from the long-term completeness and uniformity of the interactive data format financial information database. Less long-term completeness and uniformity would reduce the extent to which the amendments would enable investors and others to search and analyze the information dynamically; facilitate comparison of financial and business performance across issuers, reporting periods and industries; and, possibly, provide an opportunity to automate regulatory filings and business information processing with the potential to increase the speed, accuracy, and usability of financial disclosure. We note, however, that small entities will not be subject to the amendments until year three of the phase-in and, as all other issuers, will not be required to tag in detail the footnotes and schedules to their financial statements until their second year subject to the requirements.[364] We solicited comment on whether differing compliance, reporting or timetable requirements, a partial or complete exemption, or the use of performance rather than design standards would be consistent with our described main goal of making financial information easier for investors to analyze while assisting in automating regulatory filings and business information processing. One commenter stated that at some

[364] In this regard, in Part II.B.2 of this release we note that the additional phase-in time for companies not required to submit interactive data in year one of the phase-in period is intended to permit them to plan for and implement the interactive data reporting process after having the opportunity to learn from the experience of year one filers. We also there note that the additional phase-in time also is intended to enable us to monitor implementation and, if necessary, make appropriate adjustments to the phase-in period.

future point, all filers should be required to submit their financial statements in interactive data.[365] This commenter also stated, however, that smaller filers should, for now, be able to opt out of the requirement to submit interactive data. In this regard, the commenter stated that it did not believe there would be sufficient analyst interest in these filers to justify the costs the filers would incur. We acknowledge the commenter's views. We note, however, that even if there were relatively little analyst interest in smaller filers, the interactive data requirements are intended not only to facilitate access to and use of information by analysts but by others as well. In addition, we note that the interactive data requirements also are intended to provide an opportunity to automate regulatory filings and business information processing, with the potential to increase the speed, accuracy and usability of financial disclosure.

Based in part on our experience with the voluntary program, we believe that the amendments are sufficiently clear and straightforward.

VII. STATUTORY AUTHORITY AND TEXT OF AMENDMENTS

We are adopting the amendments outlined above under Sections 7, 10, 19(a) and 28 of the Securities Act,[366] Sections 3, 12, 13, 14, 15(d), 23(a), 35A, and 36 of the Exchange Act,[367]

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[365] See letter from NYSSCPA.

[366] 15 U.S.C. 77g, 77j, 77s(a) and 77z-3.

[367] 15 U.S.C. 78c, 78l, 78m, 78n, 78o(d), 78w(a), 78ll, and 78mm.

Sections 314 and 319 of the Trust Indenture Act[368] and Sections 6(c), 8, 24, 30, and 38 of the Investment Company Act[369] and Section 3(a) of the Sarbanes-Oxley Act.[370]

List of Subjects

17 CFR Parts 229, 230, 232, 239, 240 and 249

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, we amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 229 — STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 — REGULATION S-K

1. The authority citation for Part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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2. Amend § 229.601 by revising the exhibit table in paragraph (a) and by revising

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[368] 15 U.S.C. 77nnn and 77sss.

[369] 15 U.S.C. 80a-6(c), 80a-8, 80a-24, 80a-29, and 80a-37.

[370] P.L. No. 107-204, 116 Stat. 745.

paragraph (b)(100) and adding paragraph (b)(101) to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) * * *

Exhibit Table

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EXHIBIT TABLE

	Securities Act Forms								Exchange Act Forms				
	S-1	S-3	S-4[1]	S-8	S-11	F-1	F-3	F-4[1]	10	8-K[2]	10-D	10-Q	10-K
(1) Underwriting agreement	X	X	X	---	X	X	X	X	---	X	---	---	---
(2) Plan of acquisition, reorganization, arrangement, liquidation or succession	X	X	X	---	X	X	X	X	X	X	---	X	X
(3) (i) Articles of incorporation	X	---	X	---	X	X	---	X	X	X	X	X	X
(ii) Bylaws	X	---	X	---	X	X	---	X	X	X	X	X	X
(4) Instruments defining the rights of security holders, including indentures	X	X	X	X	X	X	X	X	X	X	X	X	X
(5) Opinion re legality	X	X	X	X	X	X	X	X	---	---	---	---	---
(6) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(7) Correspondence from an independent accountant regarding non-reliance on a previously issued audit report or completed interim review	---	---	---	---	---	---	---	---	---	X	---	---	---
(8) Opinion re tax matters	X	X	X	---	X	X	X	X	---	---	---	---	---
(9) Voting trust agreement	X	---	X	---	X	X	---	X	X	---	---	---	X
(10) Material contracts	X	---	X	---	X	X	---	X	X	---	X	X	X

(11) Statement re computation of per share earnings	X	---	X	---	X	X	---	X	X	---	---	X	X
(12) Statements re computation of ratios	X	X	X	---	X	X	---	X	X	---	---	---	X
(13) Annual report to security holders, Form 10-Q or quarterly report to security holders[3]	---	---	X	---	---	---	---	---	---	---	---	---	X
(14) Code of Ethics										X	---		X
(15) Letter re unaudited interim financial information	X	X	X	X	X	X	X	X	---	---	---	X	---
(16) Letter re change in certifying accountant[4]	X	---	X	---	X	---	---	---	X	X	---	---	X
(17) Correspondence on departure of director	---	---	---	---	---	---	---	---	---	X	---	---	---
(18) Letter re change in accounting principles	---	---	---	---	---	---	---	---	---	---	---	X	X
(19) Report furnished to security holders	---	---	---	---	---	---	---	---	---	---	---	X	---
(20) Other documents or statements to security holders	---	---	---	---	---	---	---	---	---	X	---	---	---
(21) Subsidiaries of the registrant	X	---	X	---	X	X	---	X	X	---	---	---	X
(22) Published report regarding matters submitted to vote of security holders	---	---	---	---	---	---	---	---	---	---	X	X	X
(23) Consents of experts and counsel	X	X	X	X	X	X	X	X	---	X[5]	X[5]	X[5]	X[5]
(24) Power of attorney	X	X	X	X	X	X	X	X	X	X	---	X	X
(25) Statement of eligibility of trustee	X	X	X	---	---	X	X	X	---	---	---	---	---
(26) Invitation for competitive bids	X	X	X	---	---	X	X	X	---	---	---	---	---
(27) through (30) [Reserved]													

(i) Rule 13a- 15d-14(a) Certifications	---	---	---	---	---	---	---	---	---	---	---	X	X
(ii) Rule 13a-14 15d-14 Certifications												---	X
(32) Section 1350 Certifications[6]	---	---	---	---	---	---	---	---	---	---	---	X	X
(33) Report on assessment of compliance with servicing criteria for asset-backed issuers	---	---	---	---	---	---	---	---	---	---	---	---	X
(34) Attestation report on assessment of compliance with servicing criteria for asset-backed securities	---	---	---	---	---	---	---	---	---	---	---	---	X
(35) Servicer compliance statement	---	---	---	---	---	---	---	---	---	---	---	---	X
(36) through (98) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(99) Additional exhibits	X	X	X	X	X	X	X	X	X	X	X	X	X
(100) XBRL-Related Documents									X	X		X	X
(101) Interactive Data File	X	X	X	---	X	X	X	X	---	X	---	X	X

[1] An exhibit need not be provided about a company if: (1) With respect to such company an election has been made under Form S-4 or F-4 to provide information about such company at a level prescribed by Form S-3 or F-3; and (2) the form, the level of which has been elected under Form S-4 or F-4, would not require such company to provide such exhibit if it were registering a primary offering.

[2] A Form 8-K exhibit is required only if relevant to the subject matter reported on the Form 8-K report. For example, if the Form 8-K pertains to the departure of a director, only the exhibit described in paragraph (b)(17) of this section need be filed. A required exhibit may be incorporated by reference from a previous filing.

[3] Where incorporated by reference into the text of the prospectus and delivered to security holders along with the prospectus as permitted by the registration statement; or, in the case of the Form 10-K, where the annual report to security holders is incorporated by reference into the text of the Form 10-K.

[4] If required pursuant to Item 304 of Regulation S-K.

[5] Where the opinion of the expert or counsel has been incorporated by reference into a previously filed Securities Act registration statement.

[6] Pursuant to §§ 240.13a-13(b)(3) and 240.15d-13(b)(3) of this chapter, asset-backed issuers are not required to file reports on Form 10-Q.

(b) * * *

(100) XBRL-Related Documents. Only an electronic filer that prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) is permitted to participate in the voluntary XBRL (eXtensible Business Reporting Language) program and, as a result, may submit XBRL-Related Documents (§232.11 of this chapter) in electronic format as an exhibit to: the filing to which they relate; an amendment to such filing; or a Form 8-K (§249.308 of this chapter) that references such filing, if the Form 8-K is submitted no earlier than the date of filing. Rule 401 of Regulation S-T (§232.401 of this chapter) sets forth further details regarding eligibility to participate in the voluntary XBRL program.

(101) Interactive Data File. An Interactive Data File (§232.11 of this chapter) is:

(i) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the registrant does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is described in paragraph (b)(101)(i)(A), (B) or (C) of this Item, except that an Interactive Data File: first is required for a periodic report on Form 10-Q (§249.308a of this chapter), Form 20-F (§249.220f of this chapter) or Form 40-F (§249.240f of this chapter), as applicable; is required for a registration statement under the Securities Act only if the registration statement contains a price or price range; and is required for a Form 8-K (§249.308 of this chapter) only when the

Form 8-K contains audited annual financial statements that are a revised version of financial statements that previously were filed with the Commission that have been revised pursuant to applicable accounting standards to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments or a change in accounting principle, and, in such case, the Interactive Data File would be required only as to such revised financial statements regardless whether the Form 8-K contains other financial statements:

(A) A large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(B) A large accelerated filer not specified in paragraph (b)(101)(i)(A) of this Item that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(C) A filer not specified in paragraph (b)(101)(i)(A) or (B) of this Item that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(ii) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the:

(A) Registrant prepares its financial statements:

(1) In accordance with either:

(i) Generally accepted accounting principles as used in the United States; or

(ii) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(2) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(B) Interactive Data File is not required to be submitted to the Commission under paragraph (b)(101)(i) of this Item.

(iii) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

PART 230 -- GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

3. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

4. Amend § 230.144 by revising paragraph (c)(1) and the Note to paragraph (c) to read as follows:

§ 230.144 Persons deemed not to be engaged in a distribution and therefore not underwriters.

* * * * *

(c) * * *

(1) Reporting issuers. The issuer is, and has been for a period of at least 90 days immediately before the sale, subject to the reporting requirements of section 13 or 15(d) of the Exchange Act and has:

(i) Filed all required reports under section 13 or 15(d) of the Exchange Act, as applicable, during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports), other than Form 8-K reports (§249.308 of this chapter); and

(ii) Submitted electronically and posted on its corporate Web site, if any, every Interactive Data File (§232.11 of this chapter) required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the 12 months preceding such sale (or for such shorter period that the issuer was required to submit and post such files); or

* * * * *

Note to paragraph (c). With respect to paragraph (c)(1), the person can rely upon:

1. A statement in whichever is the most recent report, quarterly or annual, required to be filed and filed by the issuer that such issuer has:

a. Filed all reports required under section 13 or 15(d) of the Exchange Act, as applicable, during the preceding 12 months (or for such shorter period that the issuer was required to file such reports), other than Form 8–K reports (§249.308 of this chapter), and has been subject to such filing requirements for the past 90 days; and

b. Submitted electronically and posted on its corporate Web site, if any, every Interactive Data File (§232.11 of this chapter) required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the preceding 12 months (or for such shorter period that the issuer was required to submit and post such files); or

2. A written statement from the issuer that it has complied with such reporting, submission or posting requirements.

3. Neither type of statement may be relied upon, however, if the person knows or has reason to believe that the issuer has not complied with such requirements.

* * * * *

PART 232 — REGULATION S-T — GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

5. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

6. Amend §232.11 by adding definitions for “Interactive Data File,” “Promptly,” and

"Related Official Filing" in alphabetical order to read as follows:

* * * * *

§ 232.11 Definition of terms used in part 232.

Interactive Data File. The term Interactive Data File means the machine-readable computer code that presents information in eXtensible Business Reporting Language (XBRL) electronic format pursuant to §232.405.

* * * * *

Promptly. The term Promptly means as soon as reasonably practicable under the facts and circumstances at the time. An amendment to the Interactive Data File made by the later of 24 hours or 9:30 a.m. Eastern Standard Time or Eastern Daylight Saving Time, whichever is currently in effect, on the next business day after the electronic filer becomes aware of the need for such amendment shall be deemed to be "promptly" made.

* * * * *

Related Official Filing. The term Related Official Filing means the ASCII or HTML format part of the official filing with which an Interactive Data File appears as an exhibit.

* * * * *

7. Amend § 232.201 by:

a. Revising paragraph (a) introductory text;

b. Amending paragraph (b) by revising the headings to Notes 1 and 2; and

c. Adding paragraph (c).

The revisions and addition 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 Interactive Data File (§232.11 of this chapter), 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.

* * * * *

(b) * * *

<u>Note 1 to paragraph (b)</u>: * * *

<u>Note 2 to paragraph (b)</u>: * * *

(c) If an electronic filer experiences unanticipated technical difficulties preventing the timely preparation and

(1) Submission of an Interactive Data File (§232.11) as an exhibit as required pursuant to Rule 405 of Regulation S-T (§232.405), the electronic filer still can timely satisfy the requirement to submit the Interactive Data File in the following manner:

(i) Substitute for the Interactive Data File in the required exhibit a document that sets forth the following legend:

IN ACCORDANCE WITH THE TEMPORARY HARDSHIP EXEMPTION PROVIDED BY RULE 201 OF REGULATION S-T, THE DATE BY WHICH THE INTERACTIVE DATA FILE IS REQUIRED TO BE SUBMITTED HAS BEEN EXTENDED BY SIX BUSINESS DAYS; and

(ii) Submit the required Interactive Data File no later than six business days after the Interactive Data File originally was required to be submitted.

(2) Posting on its corporate Web site of an Interactive Data File as required pursuant to Rule 405 of Regulation S-T, the electronic filer still can timely satisfy the requirement to post the Interactive Data File by so posting the Interactive Data File within six business days after the Interactive Data File was required to be submitted to the Commission.

Note to paragraph (c): Electronic filers unable to submit or post, as applicable, the Interactive Data File under the circumstances specified by paragraph (c), must comply with the provisions of this section and cannot use Form 12b-25 (§249.322 of this chapter) as a notification of late filing. Failure to submit or post, as applicable, the Interactive Data File as required by the end of the six-business-day period specified by paragraph (c) of this section will result in ineligibility to use Forms S-3, S-8 and F-3 (§§239.13, 239.16b and 239.33 of this chapter) and constitute a failure to have filed all required reports for purposes of the current public information requirements of Rule 144(c)(1) (§230.144(c)(1) of this chapter).

8. Amend § 232.202 by:

a. Revising paragraphs (a) introductory text, (a)(2), (b)(2), and (b)(3);

b. Revising paragraph (c);

c. Revising paragraph (d);

d. Revising the headings to Notes 1, 2, and 3 to the section; and

e. Adding Note 4 to the section.

The revisions and addition read as follows:

§ 232.202 Continuing hardship exemption.

(a) An electronic filer may apply in writing for a continuing hardship exemption if all or part of a filing, group of filings or submission, other than a Form ID (§§ 239.63, 249.446, 269.7, and 274.402 of this chapter) or a Form D (§ 239.500 of this chapter), otherwise to be filed or submitted in electronic format or, in the case of an Interactive Data File (§232.11), to be posted on the electronic filer's corporate Web site, cannot be so filed, submitted or posted, as applicable, without undue burden or expense. Such written application shall be made at least ten business days before the required due date of the filing(s), submission(s) or posting of the proposed filing, submission or posting date, as appropriate, or within such shorter period as may be permitted. The written application shall contain the information set forth in paragraph (b) of this section.

* * * * *

(2) If the Commission, or the staff acting pursuant to delegated authority, denies the application for a continuing hardship exemption, the electronic filer shall file or submit the required document or Interactive Data File in electronic format or post the Interactive Data File on its corporate Web site, as applicable, on the required due date or the proposed filing or submission date, or such other date as may be permitted.

* * * * *

(b) * * *

(2) The burden and expense to employ alternative means to make the electronic submission or posting, as applicable; and/or

(3) The reasons for not submitting electronically the document, group of documents or Interactive Data File or not posting the Interactive Data File, as well as the justification for the requested time period.

(c) If the request is granted with respect to:

(1) Electronic filing of a document or group of documents, not electronic submission or posting of an Interactive Data File, then the electronic filer shall submit the document or group of documents for which the continuing hardship exemption is granted in paper format on the required due date specified in the applicable form, rule or regulation, or the proposed filing date, as appropriate and the following legend shall be placed in capital letters at the top of the cover page of the paper format document(s):

IN ACCORDANCE WITH RULE 202 OF REGULATION S-T, THIS (specify document) IS BEING FILED IN PAPER PURSUANT TO A CONTINUING HARDSHIP EXEMPTION.

(2) Electronic submission of an Interactive Data File, then the electronic filer shall substitute for the Interactive Data File in the exhibit in which it was required a document that sets forth one of the following legends, as appropriate:

IN ACCORDANCE WITH A CONTINUING HARDSHIP EXEMPTION OBTAINED UNDER RULE 202 OF REGULATION S-T, THE DATE BY WHICH THE INTERACTIVE DATA FILE IS REQUIRED TO BE SUBMITTED HAS BEEN EXTENDED TO (specify date); or.

IN ACCORDANCE WITH A CONTINUING HARDSHIP EXEMPTION OBTAINED UNDER RULE 202 OF REGULATION S-T, THE INTERACTIVE DATA FILE IS NOT REQUIRED TO BE SUBMITTED.

(3) Web site posting by an electronic filer of its Interactive Data File, the electronic filer need not post on its Web site any statement with regard to the grant of the request.

(d) If a continuing hardship exemption is granted for a limited period of time for:

(1) Electronic filing of a document or group of documents, not electronic submission or posting of an Interactive Data File, then the grant may be conditioned upon the filing of the document or group of documents that is the subject of the exemption in electronic format upon the expiration of the period for which the exemption is granted. The electronic format version shall contain the following statement in capital letters at the top of the first page of the document:

THIS DOCUMENT IS A COPY OF THE (specify document) FILED ON (DATE) PURSUANT TO A RULE 202(d) CONTINUING HARDSHIP EXEMPTION.

(2) Electronic submission or posting of an Interactive Data File, then the grant may be conditioned upon the electronic submission and posting, as applicable, of the Interactive Data File that is the subject of the exemption upon the expiration of the period for which the exemption is granted.

Note 1 to §232.202: * * *

Note 2 to §232.202: * * *

Note 3 to §232.202: * * *

Note 4 to §232.202: Failure to submit or post, as applicable, the Interactive Data File as required by Rule 405 by the end of the continuing hardship exemption if granted for a limited period of time, will result in ineligibility to use Forms S-3, S-8, and F-3 (§§239.13, 239.16b and 239.33 of this chapter) and constitute a failure to have filed all required reports for purposes of the current public information requirements of Rule 144(c)(1) (§230.144(c)(1) of this chapter).

9. Amend §232.305 by revising paragraph (b) to read as follows:

§ 232.305 Number of characters per line; tabular and columnar information.

* * * * *

(b) Paragraph (a) of this section does not apply to HTML documents, Interactive Data Files (§232.11) or XBRL-Related Documents (§232.11).

10. Amend §232.401, paragraph (a), by adding a new first sentence to read as follows:

§ 232.401 XBRL-Related Document submissions.

(a) Only an electronic filer that is an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et. seq.), a "business development company" as defined in section 2(a)(48) of that Act, or an entity that reports under the Exchange Act and prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) is permitted to participate in the voluntary XBRL (eXtensible Business Reporting Language) program. * * *

* * * * *

11. Amend §232.402 by removing the phrase "Public Utility Act," from the first sentence of paragraph (b).

§§ 232.403 and §232.404 [Reserved].

12. Reserve §232.403 and §232.404.

13. Add §232.405 and §232.406T to read as follows:

§ 232.405 Interactive Data File submissions and postings.

Preliminary Note 1. Sections 405 and 406T of Regulation S-T (§§232.405 and 232.406T) apply to electronic filers that submit or post Interactive Data Files. Item 601(b)(101) of Regulation S-K (§229.601(b)(101) of this chapter), paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of both Form F-9 (§239.39 of this chapter) and Form F-10 (§239.40 of this chapter), Item 101 of the Instructions as to Exhibits of Form 20-F (§249.220f of this chapter), paragraph B.7 of the General Instructions to Form 40-F (§249.240f of this chapter) and paragraph C.6 of the General Instructions to Form 6-K (§249.306 of this chapter) specify when electronic filers are required or permitted to submit or post an Interactive Data File (§232.11), as further described in the Note to §232.405.

Preliminary Note 2. Section 405 imposes content, format, submission and Web site posting requirements for an Interactive Data File, but does not change the substantive content requirements for the financial and other disclosures in the Related Official Filing (§232.11).

Preliminary Note 3. Section 406T addresses liability related to Interactive Data Files.

(a) Content, format, submission and posting requirements – General. An Interactive Data File must:

(1) Comply with the content, format, submission and Web site posting requirements of this section;

(2) Be submitted only by an electronic filer either required or permitted to submit an Interactive Data File as specified by Item 601(b)(101) of Regulation S-K, paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of either Form F-9 or Form F-10, Item 101 of the Instructions as to Exhibits of Form 20-F, paragraph B.7 of the General

Instructions to Form 40-F or paragraph C.6 of the General Instructions to Form 6-K, as applicable, as an exhibit to:

(i) A form that contains the disclosure required by this section or

(ii) An amendment to a form that contains the disclosure required by this section if the amendment is filed no more than 30 days after the earlier of the due date or filing date of the form and the Interactive Data File is the first Interactive Data File the electronic filer submits or the first Interactive Data File the electronic filer submits that complies or is required to comply, whichever occurs first, with paragraphs (d)(1) through (d)(4), (e)(1) and (e)(2) of this section;

(3) Be submitted in accordance with the EDGAR Filer Manual and, as applicable, either Item 601(b)(101) of Regulation S-K, paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of either Form F-9 or Form F-10, Item 101 of the Instructions as to Exhibits of Form 20-F, paragraph B.7 of the General Instructions to Form 40-F or paragraph C.6 of the General Instructions to Form 6-K; and

(4) Be posted on the electronic filer's corporate Web site, if any, in accordance with, as applicable, either Item 601(b)(101) of Regulation S-K, paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of either Form F-9 or Form F-10, Item 101 of the Instructions as to Exhibits of Form 20-F, paragraph B.7 of the General Instructions to Form 40-F or paragraph C.6 of the General Instructions to Form 6-K.

(b) Content - categories of information presented. An Interactive Data File must consist of only a complete set of information for all periods required to be presented in the corresponding data in the Related Official Filing, no more and no less, from all of the following categories:

(1) The complete set of the electronic filer's financial statements (which includes the face of the financial statements and all footnotes); and

(2) All schedules set forth in Article 12 of Regulation S-X (§§210.12-01 - 210.12-29) related to the electronic filer's financial statements.

Note to paragraph (b): It is not permissible for the Interactive Data File to present only partial face financial statements, such as by excluding comparative financial information for prior periods.

(c) Format – Generally. An Interactive Data File must comply with the following requirements, except as modified by paragraph (d) or (e) of this section, as applicable, with respect to the corresponding data in the Related Official Filing consisting of footnotes to financial statements or financial statement schedules as set forth in Article 12 of Regulation S-X:

(1) Data elements and labels.

(i) Element accuracy. Each data element (i.e., all text, line item names, monetary values, percentages, numbers, dates and other labels) contained in the Interactive Data File reflects the same information in the corresponding data in the Related Official Filing;

(ii) Element specificity. No data element contained in the corresponding data in the Related Official Filing is changed, deleted or summarized in the Interactive Data File;

(iii) Standard and special labels and elements. Each data element contained in the Interactive Data File is matched with an appropriate tag from the most recent version of the standard list of tags specified by the EDGAR Filer Manual. A tag is appropriate only when its standard definition, standard label and other attributes as and to the extent identified in the list of tags match the information to be tagged, except that:

(A) Labels. An electronic filer must create and use a new special label to modify a tag's existing standard label when that tag is an appropriate tag in all other respects (i.e., in order to use a tag from the standard list of tags only its label needs to be changed); and

(B) Elements. An electronic filer must create and use a new special element if and only if an appropriate tag does not exist in the standard list of tags for reasons other than or in addition to an inappropriate standard label; and

(2) Additional mark-up related content. The Interactive Data File contains any additional mark-up related content (e.g., the eXtensible Business Reporting Language tags themselves, identification of the core XML documents used and other technology related content) not found in the corresponding data in the Related Official Filing that is necessary to comply with the EDGAR Filer Manual requirements.

(d) Format – Footnotes - Generally. The part of the Interactive Data File for which the corresponding data in the Related Official Filing consists of footnotes to financial statements must comply with the requirements of paragraphs (c)(1) and (c)(2) of this section, as modified by this paragraph (d), unless the electronic filer is within one of the categories specified in paragraph (f) of this section. Footnotes to financial statements must be tagged as follows:

(1) Each complete footnote must be block-text tagged;

(2) Each significant accounting policy within the significant accounting policies footnote must be block-text tagged;

(3) Each table within each footnote must be block-text tagged; and

(4) Within each footnote,

(i) Each amount (i.e., monetary value, percentage, and number) must be tagged separately; and

(ii) Each narrative disclosure may be tagged separately to the extent the electronic filer chooses.

(e) Format – Schedules - Generally. The part of the Interactive Data File for which the corresponding data in the Related Official Filing consists of financial statement schedules as set forth in Article 12 of Regulation S-X must comply with the requirements of paragraphs (c)(1) and (c)(2) of this section, as modified by this paragraph (e), unless the electronic filer is within one of the categories specified in paragraph (f) of this section. Financial statement schedules as set forth in Article 12 of Regulation S-X must be tagged as follows:

(1) Each complete financial statement schedule must be block-text tagged; and

(2) Within each financial statement schedule,

(i) Each amount (i.e., monetary value, percentage and number) must be tagged separately; and

(ii) Each narrative disclosure may be tagged separately to the extent the electronic filer chooses.

(f) Format – Footnotes and Schedules Eligible for Phased-In Detail. The following electronic filers must comply with paragraphs (c)(1) and (c)(2) of this section as modified by paragraphs (d) and (e) of this section, except that they may choose to comply with paragraph (d)(1) of this section rather than paragraphs (d)(1) through (d)(4) of this section and may choose to comply with paragraph (e)(1) of this section rather than paragraphs (e)(1) and (e)(2) of this section:

(1) Any large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States, if none of the financial statements for which an Interactive Data File is required is for a fiscal period that ends on or after June 15, 2010;

(2) Any large accelerated filer not specified in paragraph (f)(1) of this section that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States, if none of the financial statements for which an Interactive Data File is required is for a fiscal period that ends on or after June 15, 2011; and

(3) Any filer not specified in paragraph (f)(1) or (f)(2) of this section that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, if none of the financial statements for which an Interactive Data File is required is for a fiscal period that ends on or after June 15, 2012.

(g) Posting. Any electronic filer that maintains a corporate Web site and is required to submit an Interactive Data File must post that Interactive Data File on that Web site by the end of the calendar day on the earlier of the date the Interactive Data File is submitted or is required to be submitted and the Interactive Data File must remain accessible on that Web site for at least a 12-month period.

Note to §232.405: Item 601(b)(101) of Regulation S-K specifies the circumstances under which an Interactive Data File must be submitted as an exhibit and be posted to the issuer's corporate Web site, if any, and the circumstances under which it is permitted to be submitted as an exhibit, with respect to Forms S-1 (§239.11 of this chapter), S-3 (§239.13 of this chapter), S-4 (§239.25 of this chapter), S-11 (§239.18 of this chapter), F-1 (§239.31 of this chapter), F-3 (§239.33 of this chapter), F-4 (§239.34 of this chapter), 10-K (§249.310 of this chapter), 10-Q (§249.308a of this chapter) and 8-K (§249.308 of this chapter). Paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of both Form F-9 and Form F-10 specifies the circumstances under which an Interactive Data File must be submitted as an exhibit and be posted to the issuer's corporate Web site, if any, and the circumstances under which it is permitted to be submitted as an exhibit, with respect to Form F-9 and Form F-10, respectively. Item 101 of the Instructions as to Exhibits of Form 20-F specifies the circumstances under which an Interactive Data File must be submitted as an exhibit and be posted to the issuer's corporate Web site, if any, and the circumstances under which it is permitted to be submitted as an exhibit, with respect to Form 20-F. Paragraph B.7 of the General Instructions to Form 40-F and Paragraph C.6 of the General Instructions to Form 6-K specify the circumstances under which an Interactive Data File must be submitted as an exhibit and be posted to the issuer's corporate Web site, if any, and the circumstances under which it is permitted to be submitted as an exhibit, with respect to Form 40-F and Form 6-K, respectively. Item 601(b)(101) of Regulation S-K, paragraph 101 of the Information Not Required to be Delivered to Offerees or Purchasers of both Form F-9 and Form F-10, Item 101 of the Instructions as to Exhibits of Form 20-F, paragraph B.7 of the General Instructions to Form 40-F and paragraph C.6 of the General Instructions to Form 6-K all prohibit submission of an

Interactive Data File by an issuer that prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

§ 232.406T Temporary rule related to Interactive Data Files.

(a) Scope. Section 232.406T addresses the liability for the Interactive Data File. An Interactive Data File is subject to the same liability provisions as the Related Official Filing except as provided in paragraphs (b) and (c) of this section.

(b) In general. The Interactive Data File, regardless of whether it is an exhibit to a document incorporated by reference into filings:

(1) Is subject to the anti-fraud provisions of section 17(a)(1) of the Securities Act, section 10(b) of the Exchange Act, §240.10b-5 of this chapter, and section 206(1) of the Investment Advisers Act except as provided in paragraph (c) of this section;

(2) Is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed not filed for purposes of section 18 of the Exchange Act or section 34(b) of the Investment Company Act, and otherwise is not subject to liability under these sections; and

(3) Is deemed filed for purposes of §232.103.

(c) Good faith attempts and prompt correction. Subject to paragraph (b) of this section, the Interactive Data File shall be subject to liability for a failure to comply with §232.405, but shall be deemed to have complied with §232.405 and would not be subject to liability under the anti-fraud provisions set forth in paragraph (b)(1) of this section or under any other liability provision if the electronic filer:

(1) Makes a good faith attempt to comply with §232.405; and

(2) After the electronic filer becomes aware that the Interactive Data File fails to comply with §232.405, promptly amends the Interactive Data File to comply with §232.405.

(d) Temporary section. Section 232.406T is a temporary section that applies to an Interactive Data File submitted to the Commission less than 24 months after the electronic filer first was required to submit an Interactive Data File to the Commission pursuant to § 232.405, not taking into account any grace period, but no later than October 31, 2014. After these dates, an Interactive Data File is subject to the same liability provisions as the Related Official Filing. This temporary section will expire on October 31, 2014.

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

14. The authority citation for Part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

15. Amend §239.13 by revising paragraph (a)(8) to read as follows:

§ 239.13 Form S-3, for registration under the Securities Act of 1933 of securities of certain issuers offered pursuant to certain types of transactions.

* * * * *

(a) * * *

(8) Electronic filings. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(i) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule 201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(ii) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

16. Amend Form S-3 (referenced in §239.13) by revising paragraph I.A.8 of the General Instructions to read as follows:

Note – The text of Form S-3 does not and this amendment will not appear in the Code of Federal Regulations.

Form S-3

* * * * *

GENERAL INSTRUCTIONS

I. * * *

A. * * *

8. <u>Electronic filings</u>. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(a) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule

201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(b) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

* * * * *

17. Amend §239.16b by revising paragraph (b) to read as follows:

§ 239.16b Form S-8, for registration under the Securities Act of 1933 of securities to be offered to employees pursuant to employee benefit plans.

(a) * * *

(b) <u>Electronic filings</u>. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(1) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule 201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(2) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

18. Amend Form S-8 (referenced in §239.16b) by revising paragraph A.3 of the General Instructions to read as follows:

Note – The text of Form S-8 does not and this amendment will not appear in the Code of Federal Regulations.

Form S-8

* * * * *

GENERAL INSTRUCTIONS

A. * * *

3. Electronic filings. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(a) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule 201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(b) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

* * * * *

19. Amend §239.33 by revising paragraph (a)(6) to read as follows:

§ 239.33 Form F-3, for registration under the Securities Act of 1933 of securities of certain

foreign private issuers offered pursuant to certain types of transactions.

* * * * *

(a) * * *

(6) Electronic filings. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(i) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule 201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(ii) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

* * * * *

20. Amend Form F-3 (referenced in §239.33) by revising paragraph I.A.6 of the General Instructions to read as follows:

Note – The text of Form F-3 does not and this amendment will not appear in the Code of Federal Regulations.

Form F-3

* * * * *

GENERAL INSTRUCTIONS

I. * * *

A. * * *

6. Electronic filings. In addition to satisfying the foregoing conditions, a registrant subject to the electronic filing requirements of Rule 101 of Regulation S-T (§232.101 of this chapter) shall have:

(i) Filed with the Commission all required electronic filings, including electronic copies of documents submitted in paper pursuant to a hardship exemption as provided by Rule 201 or Rule 202(d) of Regulation S-T (§232.201 or §232.202(d) of this chapter); and

(ii) Submitted electronically to the Commission and posted on its corporate Web site, if any, all Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form (or for such shorter period of time that the registrant was required to submit and post such files).

* * * * *

21. Amend Form F-9 (referenced in §239.39) by reserving paragraphs (8) through (100) and adding paragraph 101 at the end of "Part II – Information Not Required to be Delivered to Offerees or Purchasers" to read as follows:

Note – The text of Form F-9 does not and this amendment will not appear in the Code of Federal Regulations.

Form F-9

* * * * *

PART II – INFORMATION NOT REQUIRED TO BE DELIVERED TO OFFEREES OR PURCHASERS

* * * * *

(8) through (100) [Reserved]

(101) An Interactive Data File (§232.11 of this chapter) is:

(a) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the Registrant does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is described in paragraph (a)(i),(ii), (iii) of this Instruction 101, except that an Interactive Data File: first is required for a periodic report on Form 10-Q (§249.308a of this chapter), Form 20-F (§249.220f of this chapter) or Form 40-F (§249.240f of this chapter), as applicable; and is required for a registration statement under the Securities Act only if the registration statement contains a price or price range:

(i) a large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(ii) a large accelerated filer not specified in paragraph (a)(i) of this Instruction (101) that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(iii) a filer not specified in paragraph (a)(i) or (a)(ii) of this Instruction (101) that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(b) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the:

(i) Registrant prepares its financial statements:

(A) In accordance with either:

(1) Generally accepted accounting principles as used in the United States; or

(2) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(B) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(ii) Interactive Data File is not required to be submitted to the Commission under paragraph (a) of this Instruction 101.

(c) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

* * * * *

22 Amend Form F-10 (referenced in §239.40) by reserving paragraphs (8) through (100) and adding paragraph 101 at the end of "Part II – Information Not Required to be Delivered to Offerees or Purchasers" to read as follows:

Note – The text of Form F-10 does not and this amendment will not appear in the Code of Federal Regulations.

Form F-10

* * * * *

PART II – INFORMATION NOT REQUIRED TO BE DELIVERED TO OFFEREES OR PURCHASERS

* * * * *

(8) through (100) [Reserved]

(101) An Interactive Data File (§232.11 of this chapter) is:

(a) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the Registrant does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is described in paragraph (a)(i),(ii), (iii) of this Instruction 101, except that an Interactive Data File: first is required for a periodic report on Form 10-Q (§249.308a of this chapter), Form 20-F (§249.220f of this chapter) or Form 40-F (§249.240f of this chapter), as applicable; and is required for a registration statement under the Securities Act only if the registration statement contains a price or price range:

(i) a large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(ii) a large accelerated filer not specified in paragraph (a)(i) of this Instruction 101 that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(iii) a filer not specified in paragraph (a)(i) or (a)(ii) of this Instruction 101 that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(b) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the:

(i) Registrant prepares its financial statements:

(A) In accordance with either:

(1) Generally accepted accounting principles as used in the United States; or

(2) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(B) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(ii) Interactive Data File is not required to be submitted to the Commission under paragraph (a) of this Instruction (101).

(c) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

* * * * *

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

23 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.

* * * * *

24. Amend §240.12b-25 by adding paragraph (h) to read as follows:

§ 240.12b-25 Notification of inability to timely file all or any required portion of a Form 10–K, 20–F, 11–K, N–SAR, N–CSR, 10–Q, or 10–D.

* * * * *

(h) Interactive data submissions. The provisions of this section shall not apply to the submission or posting of an Interactive Data File (§232.11 of this chapter). Filers unable to submit or post an Interactive Data File within the time period prescribed should comply with either Rule 201 or 202 of Regulation S-T (§232.201 and §232.202 of this chapter).

25. Amend §240.13a-14 by revising paragraph (f) to read as follows:

§ 240.13a-14 Certification of disclosure in annual and quarterly reports.

* * * * *

(f) The certification requirements of this section do not apply to:

(1) An Interactive Data File, as defined in Rule 11 of Regulation S-T (§232.11 of this chapter); or

(2) XBRL-Related Documents, as defined in Rule 11 of Regulation S-T.

26. Amend §240.15d-14 by revising paragraph (f) to read as follows:

§ 240.15d-14 Certification of disclosure in annual and quarterly reports.

* * * * *

(f) The certification requirements of this section do not apply to:

(1) An Interactive Data File, as defined in Rule 11 of Regulation S-T (§232.11 of this chapter); or

(2) XBRL-Related Documents, as defined in Rule 11 of Regulation S-T.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

27. 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.

* * * * *

28. Amend Form 10-Q (referenced in § 249.308a) by adding a paragraph with two check boxes to the cover page after the paragraph with two check boxes that starts "Indicate by check

mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months * * *" to read as follows:

Note: The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 10-Q

* * * * *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ]   No [ ]

* * * * *

29. Amend Form 10-K (referenced in § 249.310) by adding a paragraph with two check boxes to the cover page after the paragraph with two check boxes that starts "Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months * * *" to read as follows:

Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 10-K

* * * * *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ]

* * * * *

30. Amend Form 20-F (referenced in § 249.220f) by:

a. Adding a paragraph with two check boxes to the cover page after the paragraph with two check boxes that starts "Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months * * *;" and

b. Revise paragraph 100 and add paragraph 101 at the end of "Instructions as to Exhibits."

The additions and revisions read as follows:

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 20-F

* * * * *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ]

* * * * *

INSTRUCTIONS AS TO EXHIBITS

* * * * *

100. XBRL-Related Documents. Only a registrant that prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) is permitted to participate in the voluntary XBRL (eXtensible Business Reporting Language) program and, as a result, may submit XBRL-Related Documents (§232.11 of this chapter). Rule 401 of Regulation S –T (§232.401 of this chapter) sets forth further details regarding eligibility to participate in the voluntary XBRL program.

101. Interactive Data File. An Interactive Data File (§232.11 of this chapter) is:

(a) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the Form 20-F is an annual report and the registrant does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is:

(i) a large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(ii) a large accelerated filer not specified in paragraph (a)(i) of this Instruction 101 that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(iii) a filer not specified in paragraph (a)(i) or (a)(ii) of this Instruction 101 that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(b) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the:

(i) Registrant prepares its financial statements:

(A) In accordance with either:

(1) Generally accepted accounting principles as used in the United States; or

(2) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(B) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(ii) Interactive Data File is not required to be submitted to the Commission under paragraph (a) of this Instruction 101.

(c) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X

(17 CFR 210.6-01 et. seq.).

* * * * *

31. Amend Form 40-F (referenced in § 249.240f) by:

a. Adding a paragraph with two check boxes to the cover page after the paragraph with two check boxes that starts "Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months * * *;" and

b. Add paragraph B.(7) to the General Instructions.

The additions read as follows:

Note: The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 40-F

* * * * *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes [ ]   No [ ]

* * * * *

General Instructions

* * * * *

B. * * *

(7) An Interactive Data File (§232.11 of this chapter) is:

(a) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter), and, as submitted, listed as exhibit 101, if the Form 40-F is an annual report and the registrant is does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is:

(i) a large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(ii) a large accelerated filer not specified in paragraph (a)(i) of this Instruction 7 that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(iii) a filer not specified in paragraph (a)(i) or (a)(ii) of this Instruction 7 that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(b) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the registrant lists it as exhibit 101 and the:

(i) Registrant prepares its financial statements:

(A) In accordance with either:

(1) Generally accepted accounting principles as used in the United States; or

(2) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(B) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(ii) Interactive Data File is not required to be submitted to the Commission under paragraph (a) of this Instruction 7.

(c) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

* * * * *

32. Amend Form 6-K (referenced in §249.306) by revising paragraph (5) and paragraph (6) to General Instruction C to read as follows:

Note – The text of Form 6-K does not and this amendment will not appear in the Code of Federal Regulations.

FORM 6-K

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GENERAL INSTRUCTIONS

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C. * * *

(5) XBRL-Related Documents. Only a registrant that prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) is permitted to participate in the voluntary XBRL (eXtensible Business Reporting Language) program and, as a result, may submit XBRL-Related Documents (§232.11 of this chapter). XBRL-Related Documents submitted as an exhibit to a Form 6-K must be listed as exhibit 100. Rule 401 of Regulation S –T (§232.401 of this chapter) sets forth further details regarding eligibility to participate in the voluntary XBRL program.

(6) Interactive Data File. An Interactive Data File (§232.11 of this chapter) is:

(a) Required to be submitted and posted. Required to be submitted to the Commission and posted on the registrant's corporate Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) and, as submitted, listed as exhibit 101, if the registrant does not prepare its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.) and is described in paragraph (a)(i), (ii) or (iii) of this Instruction (6), except that an Interactive Data File: first is required for a periodic report on Form 10-Q (§249.308a of this chapter), Form 20-F (§249.220f of this chapter) or Form 40-F (§249.240f of this chapter), as applicable; and is required for a Form 6-K (§249.306 of this chapter) only when the Form 6-K contains either of the following: audited annual financial statements that are a revised version of financial statements that previously were filed with the Commission that have been revised pursuant to applicable accounting standards to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments or a change in accounting principle; or current interim financial statements included pursuant to the nine-month updating requirement of Item 8.A.5 of Form 20-F, and, in either such case, the Interactive Data File would be required only as to such revised financial statements current interim financial statements regardless whether the Form 6-K contains other financial statements:

(i) A large accelerated filer (§240.12b-2 of this chapter) that had an aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates of more than $5 billion as of the last business day of the second fiscal quarter of its most recently completed fiscal year that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2009;

(ii) A large accelerated filer not specified in paragraph (a)(i) of this Instruction (6) that prepares its financial statements in accordance with generally accepted accounting principles as used in the United States and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2010; or

(iii) A filer not specified in paragraph (a)(i) or (ii) of this Instruction (6) that prepares its financial statements in accordance with either generally accepted accounting principles as used in the United States or International Financial Reporting Standards as issued by the International Accounting Standards Board, and the filing contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011.

(b) Permitted to be submitted. Permitted to be submitted to the Commission in the manner provided by Rule 405 of Regulation S-T (§232.405 of this chapter) if the:

(i) Registrant prepares its financial statements:

(A) In accordance with either:

(1) Generally accepted accounting principles as used in the United States; or

(2) International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(B) Not in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.); and

(ii) Interactive Data File is not required to be submitted to the Commission under paragraph (a)(i) of this Instruction (6).

(iii) Not permitted to be submitted. Not permitted to be submitted to the Commission if the registrant prepares its financial statements in accordance with Article 6 of Regulation S-X (17 CFR 210.6-01 et. seq.).

* * * * *

33. Amend §249.322 by adding paragraph (c) to read as follows:

§ 249.322 Form 12b-25-Notification of late filing.

* * * * *

(c) Interactive data submissions. This form shall not be used by electronic filers with respect to the submission or posting of an Interactive Data File (§232.11 of this chapter). Electronic filers unable to submit or post an Interactive Data File within the time period prescribed should comply with either Rule 201 or 202 of Regulation S-T (§232.201 and §232.202 of this chapter).

34. Amend Form 12b-25 (referenced in §249.322) by adding paragraph 6 to the General Instructions to read as follows:

Note – The text of Form 12b-25 does not and this amendment will not appear in the Code of Federal Regulations.

FORM 12b-25

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GENERAL INSTRUCTIONS

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6. Interactive data submissions. This form shall not be used by electronic filers with respect to the submission or posting of an Interactive Data File (§232.11 of this chapter). Electronic filers unable to submit or post an Interactive Data File within the time period prescribed should comply with either Rule 201 or 202 of Regulation S-T (§232.201 and §232.202 of this chapter).

* * * * * Florence E. Harmon

By the Commission.

Florence E. Harmon
Deputy Secretary

Dated January 30, 2009

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 232, 239, and 274

[Release Nos. 33-8998; IC-28584; File No. S7-28-07]

RIN 3235-AJ44

ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting amendments to the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933 in order to enhance the disclosures that are provided to mutual fund investors. The amendments require key information to appear in plain English in a standardized order at the front of the mutual fund statutory prospectus. The Commission is also adopting rule amendments that permit a person to satisfy its mutual fund prospectus delivery obligations under Section 5(b)(2) of the Securities Act by sending or giving the key information directly to investors in the form of a summary prospectus and providing the statutory prospectus on an Internet Web site. Upon an investor's request, mutual funds are also required to send the statutory prospectus to the investor. These amendments are intended to improve mutual fund disclosure by providing investors with key information in plain English in a clear and concise format, while enhancing the means of delivering more detailed information to investors. Finally, the Commission is adopting additional amendments that are intended to result in the disclosure of more useful information to investors who purchase shares of exchange-traded funds on national securities exchanges.

DATES: Effective date: March 31, 2009.

Compliance Date: See Part III.D. of this release for information on compliance dates.

FOR FURTHER INFORMATION CONTACT: Kieran G. Brown, Senior Counsel; Sanjay Lamba, Senior Counsel; Devin F. Sullivan, Attorney; or Mark T. Uyeda, Assistant Director, Office of Disclosure Regulation, at (202) 551-6784, or, with respect to exchange-traded funds, Adam B. Glazer, Senior Counsel, Office of Regulatory Policy, at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-5720.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments to rules 159A,[1] 482,[2] 485,[3] 497,[4] and 498[5] under the Securities Act of 1933 ("Securities Act") and rules 304[6] and 401[7] of Regulation S-T.[8] The Commission is also adopting amendments to Form N-1A,[9] the form used by open-end management investment companies to register under the Investment Company Act of 1940 ("Investment Company Act") and to offer securities under the Securities Act;

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1 17 CFR 230.159A.

2 17 CFR 230.482.

3 17 CFR 230.485.

4 17 CFR 230.497.

5 17 CFR 230.498.

6 17 CFR 232.304.

7 17 CFR 232.401.

8 17 CFR 232.10 et seq.

9 17 CFR 239.15A and 274.11A.

Form N-4,[10] the form used by insurance company separate accounts organized as unit investment trusts and offering variable annuity contracts to register under the Investment Company Act and to offer securities under the Securities Act; and Form N-14,[11] the form used by registered management investment companies and business development companies to register under the Securities Act securities to be issued in business combinations.

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10 17 CFR 239.17b and 274.11c.

11 17 CFR 239.23.

Table of Contents

I. EXECUTIVE SUMMARY

Today, the Commission is adopting an improved mutual fund disclosure framework that it originally proposed in November 2007.[12] This improved disclosure framework is intended to provide investors with information that is easier to use and more readily accessible, while retaining the comprehensive quality of the information that is available today. The foundation of the improved disclosure framework is the provision to all investors of streamlined and user-friendly information that is key to an investment decision.

To implement the new disclosure framework, we are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a summary prospectus ("Summary Prospectus"), and the statutory prospectus will be provided on an Internet Web site.[13] Funds that select this option will also be required to send the statutory prospectus to the investor upon request.

In addition, the Commission is adopting amendments to Form N-1A relating to exchange-traded funds ("ETFs") that we proposed in a separate release in March 2008.[14]

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12 Investment Company Act Release No. 28064 (Nov. 21, 2007) [72 FR 67790 (Nov. 30, 2007)] ("Proposing Release").

13 A "statutory prospectus" is a prospectus that meets the requirements of Section 10(a) of the Securities Act [15 U.S.C. 77j(a)].

14 See Investment Company Act Release No. 28193 (Mar. 11, 2008) [73 FR 14618 (Mar. 18, 2008)] ("ETF Proposing Release").

These amendments are intended to result in the disclosure of more useful information to investors who purchase shares of exchange-traded funds on national securities exchanges.

II. BACKGROUND

Millions of individual Americans invest in shares of open-end management investment companies ("mutual funds"),[15] relying on mutual funds for their retirement, their children's education, and their other basic financial needs.[16] These investors face a difficult task in choosing among the more than 8,000 available mutual funds.[17] Fund prospectuses, which have been criticized by investor advocates, representatives of the fund industry, and others as being too long and complicated, often prove difficult for investors to use efficiently in comparing their many choices.[18] Current Commission rules

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15 An open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer. See Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a-4 and 80a-5(a)(1)].

16 Investment Company Institute, 2008 Investment Company Fact Book, at 70 (2008) ("2008 ICI Fact Book"), available at http://www.ici.org/pdf/2008_factbook.pdf (88 million individual investors own mutual funds).

17 Id. at 16 (in 2007, there were 8,752 mutual funds).

18 See, e.g., Don Phillips, Managing Director, Morningstar, Inc., Transcript of U.S. Securities and Exchange Commission Interactive Data Roundtable, at 26 (June 12, 2006), available at http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf ("June 12 Roundtable Transcript") (stating that current prospectus is "bombarding investors with way more information than they can handle and that they can intelligently assimilate"). A Webcast archive of the June 12 Interactive Data Roundtable is available at http://www.connectlive.com/events/secxbrl/. See also Investment Company Institute, Understanding Preferences for Mutual Fund Information, at 8 (Aug. 2006), available at http://ici.org/pdf/rpt_06_inv_prefs_summary.pdf ("ICI Investor Preferences Study") (noting that sixty percent of recent fund investors describe mutual fund prospectuses as very or somewhat difficult to understand, and two-thirds say prospectuses contain too much information); Associated Press Online, Experts: Investors Face Excess Information (May 25, 2005) ("There is broad agreement . . . that prospectuses have too much information . . . to be useful." (quoting Mercer Bullard, President, Fund Democracy, Inc.)); Thomas P. Lemke and Gerald T. Lins, The "Gift" of Disclosure: A Suggested Approach for Managed Investments, The Investment Lawyer, at 19 (Jan. 2001) (stating that the fund prospectus "typically contains more information than the average investor needs").

require mutual fund prospectuses to contain key information about investment objectives, risks, and expenses that, while important to investors, can be difficult for investors to extract. Prospectuses are often long, both because they contain a wealth of detailed information, which our rules require, and because prospectuses for multiple funds are often combined in a single document. Too frequently, the language of prospectuses is complex and legalistic, and the presentation formats make little use of graphic design techniques that would contribute to readability.

Numerous commentators have suggested that investment information that is key to an investment decision should be provided in a streamlined document with other more detailed information provided elsewhere.[19] Furthermore, recent investor surveys indicate that investors prefer to receive information in concise, user-friendly formats.[20]

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[19] See, e.g., Charles A. Jaffe, Improving Disclosure of Funds Can Be Done, The Fort Worth Star-Telegram (May 7, 2006) ("Bring back the profile prospectus, and make its use mandatory. . . . A two page-summary of [the] key points [in the profile] – at the front of the prospectus – would give investors the bare minimum of what they should know out of the paperwork."); Experts: Investors Face Excess Information, supra note 18 (stating "a possible middle ground in the disclosure debate is to rely more heavily on so-called profile documents which provide a two-page synopsis of a fund" (attributing statement to Mercer Bullard, President, Fund Democracy, Inc.)); Mutual Funds: A Review of the Regulatory Landscape, Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the Comm. on Financial Services, U.S. House of Representatives, 109th Cong. (May 10, 2005), at 24 ("To my mind, a new and enhanced mutual fund prospectus should have two core components. It should be short, addressing only the most important factors about which typical fund investors care in making investment decisions, and it should be supplemented by additional information available electronically, specifically through the Internet, unless an investor chooses to receive additional information through other means." (Testimony of Barry P. Barbash, then Partner, Shearman & Sterling LLP)); Thomas P. Lemke and Gerald T. Lins, The "Gift" of Disclosure: A Suggested Approach for Managed Investments, supra note 18, at 19 (information that is important to investors includes goals and investment policies, risks, costs, performance, and the identity and background of the manager).

In addition, a mutual fund task force organized by the National Association of Securities Dealers, Inc. ("NASD") supported the use of a "profile plus" document, on the Internet, that would include, among other things, basic information about a fund's investment strategies, risks, and total costs, with hyperlinks to additional information in the prospectus. See NASD Mutual Fund Task Force, Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 2005), available at

Similar opinions were voiced at a roundtable held by the Commission in June 2006, at which representatives from investor groups, the mutual fund industry, analysts, and others discussed how the Commission could change the mutual fund disclosure framework so that investors would be provided with better information. Significant discussion at the roundtable concerned the importance of providing mutual fund investors with access to key fund data in a shorter, more easily understandable format.[21] The participants focused on the importance of providing mutual fund investors with shorter disclosure documents, containing key information, with more detailed disclosure documents available to investors and others who choose to review additional information.[22] There was consensus among the roundtable participants that the key information that investors need to make an investment decision includes information

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http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p013690.pdf ("NASD Mutual Fund Task Force Report"). The name of NASD has been changed to the Financial Industry Regulatory Authority, Inc. ("FINRA").

20 See ICI Investor Preferences Study, supra note 18, at 29 ("Nearly nine in 10 recent fund investors say they prefer a summary of the information they want to know before buying fund shares, either alone or along with a detailed document . . . . Just 13 percent prefer to receive only a detailed document."); Barbara Roper and Stephen Brobeck, Consumer Federation of America, Mutual Fund Purchase Practices, at 13-14 (June 2006), available at http://www.consumerfed.org/pdfs/mutual_fund_survey_report.pdf (survey respondents more likely to consult a fund summary document rather than a prospectus or other written materials).

21 See, e.g., Henry H. Hopkins, Vice President and Chief Legal Counsel, T. Rowe Price Group, Inc., June 12 Roundtable Transcript, supra note 18, at 31 ("[S]hareholders prefer receiving a concise summary of fund information before buying.").

22 See, e.g., Don Phillips, Managing Director, Morningstar, Inc., id. at 27 (stating that mutual fund investors need two different documents, including a simplified print document and a tagged electronic document); Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, id. at 72-73 (urging the Commission to consider permitting mutual funds to "deliver a clear concise disclosure document . . . much like the profile prospectus" with a statement that additional disclosure is available on the funds' Web site or upon request in paper).

about a mutual fund's investment objectives and strategies, risks, costs, and performance.[23]

The roundtable participants also discussed the potential benefits of increased Internet availability of fund disclosure documents, which include, among other things, facilitating comparisons among funds and replacing "one-size-fits-all" disclosure with disclosure that each investor can tailor to his or her own needs.[24] In recent years, access to the Internet has greatly expanded,[25] and significant strides have been made in the speed

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23 See, e.g., Barbara Roper, Director of Investor Protection, Consumer Federation of America, id. at 20 (noting that there is "agreement to the point of near unanimity about the basic factors that investors should consider when selecting a mutual fund. These closely track the content of the original fund profile with highest priority given to investment objectives and strategies, risks, costs, and past performance particularly as it relates to the volatility of past returns."). See also Paul G. Haaga, Jr., Executive Vice President, Capital Research and Management Company, id. at 90 (stating that the Commission should "specify some minimum amounts of information" to provide investors with "something along the lines of the [fund] profile"); Henry H. Hopkins, Vice President and Chief Legal Counsel, T. Rowe Price Group, Inc., id. at 31 ("The profile is an excellent well organized disclosure document whose content requirements were substantiated by SEC-sponsored focus groups and an industry pilot program.").

24 See, e.g., Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, id. at 70-71 (stating that the Internet can serve as "far more than a stand-in for paper documents . . . . It can . . . put investors in control when it comes to information about their investments."); Don Phillips, Managing Director, Morningstar, Inc., id. at 49 (discussing "the ability to use the Internet as a tool for comparative shopping").

25 Recent surveys show that Internet use among adults is at an all time high with approximately three quarters of Americans having access to the Internet. See A Typology of Information and Technology Users, Pew Internet & American Life Project, at 2 (May 2007), available at http://www.pewinternet.org/pdfs/PIP_ICT_Typology.pdf; Internet Penetration and Impact, Pew Internet & American Life Project, at 3 (Apr. 2006), available at http://www.pewinternet.org/pdfs/PIP_Internet_Impact.pdf. Further, while some have noted a "digital divide" for certain groups, see, e.g., Susannah Fox, Digital Divisions, Pew Internet & American Life Project, at 1 (Oct. 5, 2005) (noting that certain groups lag behind in Internet usage, including Americans age 65 and older, African-Americans, and those with less education), others have noted that this divide may be diminishing for those groups. See, e.g., Mutual Fund Shareholders' Use of the Internet, 2006, Investment Company Institute, Research Fundamentals, at 7 (Oct. 2006), available at http://www.ici.org/stats/res/fm-v15n6.pdf ("Recent increases in Internet access among older shareholders . . . have narrowed the generational gap considerably. Today, shareholders age 65 or older are more than twice as likely to have Internet access than in 2000."); Michel Marriott, Blacks Turn to Internet Highway, And Digital Divide Starts to

and quality of Internet connections.[26] The Commission has already harnessed the power of these technological advances to provide better access to information in a number of areas. Recently, for example, we created a program that permits issuers, on a voluntary basis, to submit to the Commission financial information and, in the case of mutual funds, key prospectus information, in an interactive data format that facilitates automated retrieval, analysis, and comparison of the information.[27] More recently, we proposed rules that would require mutual funds to provide the risk/return summary section of their prospectuses, and companies to provide their financial statements, to the Commission in interactive data format.[28] In addition, we recently adopted rules that provide all shareholders with the ability to choose whether to receive proxy materials in paper or via the Internet.[29]

As suggested by the participants at the June 2006 roundtable, advances in technology also offer a promising means to address the length and complexity of mutual

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Close, THE NEW YORK TIMES (Mar. 31, 2006), available at: http://www.nytimes.com/2006/03/31/us/31divide.html?ex=1301461200&en=6fd4e942aaaa04ad&ei=5088 ("African-Americans are steadily gaining access to and ease with the Internet, signaling a remarkable closing of the 'digital divide' that many experts had worried would be a crippling disadvantage in achieving success.").

26 See John B. Horrigan, Home Broadband Adoption 2007, Pew Internet & American Life Project, at 1 (June 2007), available at http://www.pewinternet.org/pdfs/PIP_Broadband%202007.pdf (47% of all adult Americans had a broadband connection at home as of early 2007).

27 See Investment Company Act Release No. 27884 (July 11, 2007) [72 FR 39290 (July 17, 2007)] (adopting rule amendments to enable mutual funds voluntarily to submit supplemental tagged information contained in the risk/return summary section of their prospectuses); Securities Act Release No. 8529 (Feb. 3, 2005) [70 FR 6556 (Feb. 8, 2005)] (adopting rule amendments to enable registrants voluntarily to submit supplemental tagged financial information).

28 Investment Company Act Release No. 28298 (June 10, 2008) [73 FR 35442 (June 23, 2008)]; Securities Act Release No. 8924 (May 30, 2008) [73 FR 32794 (June 10, 2008)].

29 Exchange Act Release No. 56135 (July 26, 2007) [72 FR 42222 (Aug. 1, 2007)].

fund prospectuses by streamlining the key information that is provided to investors, ensuring that access to the full wealth of information about a fund is immediately and easily accessible, and providing the means to present all information about a fund online in an interactive format that facilitates comparisons of key information, such as expenses, across different funds and different share classes of the same fund.[30] Technology has the potential to replace the current one-size-fits-all mutual fund prospectus with an approach that allows investors, their financial intermediaries, third-party analysts, and others to tailor the wealth of available information to their particular needs and circumstances.

In November 2007, the Commission proposed an improved mutual fund disclosure framework that was intended to address the concerns that have been raised about mutual fund prospectuses and to make use of technological advances to enhance the provision of information to mutual fund investors. The Commission received approximately 155 comment submissions.[31] The commenters generally supported the proposals, with some commenters suggesting specific changes to the proposals. Commission staff also arranged for investor focus group testing of the proposed Summary Prospectus.[32] Today, the Commission is adopting the proposed amendments

30 A mutual fund may issue more than one class of shares that represent interests in the same portfolio of securities with each class, among other things, having a different arrangement for shareholder services or the distribution of securities, or both. See rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3].

31 In response to the ETF Proposing Release, the Commission received seven comment submissions that addressed the proposed ETF amendments to Form N-1A.

32 The Commission engaged a consultant to conduct focus group interviews and a telephone survey concerning investors' views and opinions about various disclosure documents filed by companies, including mutual funds. During this process, investors participating in focus groups were asked questions about a hypothetical Summary Prospectus. Investors participating in the telephone survey were asked questions relating to several disclosure documents, including mutual fund prospectuses. We have placed in the comment file (available at http://www.sec.gov/comments/s7-28-07/s72807.shtml) for the proposed rule the following documents from the investor testing that relate to mutual

with modifications to respond to the focus group testing and to address commenters' recommendations.

We are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. This key information is required to be presented in plain English in a standardized order. Our intent is that this information will be presented succinctly, in three or four pages, at the front of the prospectus.

We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus will be provided on an Internet Web site. Upon an investor's request, funds will also be required to send the statutory prospectus to the investor. Our intent in providing this option is that funds take full advantage of the Internet's search and retrieval capabilities in order to enhance the provision of information to mutual fund investors.

The disclosure framework that we are adopting has the potential to revolutionize the provision of information to the millions of investors who rely on mutual funds for their most basic financial needs. It is intended to help investors who are overwhelmed by the choices among thousands of available funds described in lengthy and legalistic

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fund prospectuses and the proposed Summary Prospectus: (1) the consultant's report concerning focus group testing of the hypothetical Summary Prospectus and related disclosures ("Focus Group Report"); (2) transcripts of focus groups relating to the hypothetical Summary Prospectus and related disclosures ("Focus Group Transcripts"); (3) disclosure examples used in these focus groups; and (4) an excerpt from the consultant's report concerning the telephone survey of individual investors ("Telephone Survey Report").

documents to access readily key information that is important to an informed investment decision. At the same time, by harnessing the power of technology to deliver information in better, more useable formats, the disclosure framework can help those investors, their intermediaries, third-party analysts, the financial press, and others to locate and compare facts and data from the wealth of more detailed disclosures that are available.

III. DISCUSSION

A. Amendments to Form N-1A

The Commission is adopting, with modifications to address commenters' suggestions, amendments to Form N-1A that will require the statutory prospectus of every mutual fund to include a summary section at the front of the prospectus consisting of key information presented in plain English in a standardized order.[33] Commenters and investors participating in focus groups arranged by Commission staff generally supported the proposed summary presentation and agreed that it will address investors' preferences for concise, user-friendly information.[34] The summary section will provide investors with key information about the fund that investors can use to evaluate and compare the fund. This summary will be located in a standardized, easily accessible place and will be available to all investors, regardless of whether the fund uses a Summary Prospectus and whether the investor is reviewing the prospectus in a paper or electronic format.

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33 The Commission is also adopting amendments to Form N-1A relating to exchange-traded funds. See discussion infra Part III.A.4.

34 See, e.g., Letter of AARP (Feb. 28, 2008) ("AARP Letter"); Letter of Capital Research and Management Company (Feb. 28, 2008) ("Capital Research Letter"); Letter of Fund Democracy, Consumer Federation of America, and Consumer Action (Feb. 28, 2008) ("Fund Democracy et al. Letter"); Letter of Investment Company Institute (Feb. 28, 2008) ("ICI Letter"); Letter of Mutual Fund Directors Forum (Feb. 28, 2008) ("MFDF Letter"); Letter of Morningstar, Inc. (Feb. 27, 2008) ("Morningstar Letter"); Focus Group Report, supra note 32, at 5.

As in our proposal, the information required in the summary section of the prospectus will be the same as that required in the new Summary Prospectus, and it is key information that is important to an investment decision. We believe, and commenters generally agreed,[35] that the key information that is important to an investment decision is the same, whether an investor is reviewing the summary section of a statutory prospectus or a short-form disclosure document. For that reason, we are requiring the same information in the summary section of the statutory prospectus and in the Summary Prospectus. In each case, our intent is that funds prepare a concise summary (on the order of three or four pages) that will provide key information.

In addition, with the exception of some information that is common to multiple funds, we are requiring, as proposed, that the summary section be presented separately for each fund covered by a multiple fund prospectus and that the information for multiple funds not be integrated.[36] This requirement is intended to assist investors in finding important information regarding the particular fund in which they are interested. Multiple fund prospectuses contribute substantially to prospectus length and complexity, which act as barriers to understanding. We have concluded that requiring a self-contained summary section for each fund will significantly aid investors' ability to use multiple fund prospectuses effectively.

The Commission is committed to encouraging statutory prospectuses that are simpler, clearer, and more useful to investors. The prospectus summary section is

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35 See, e.g., Letter of Bo Li (Feb. 28, 2008) ("Bo Li Letter"); Letter of Data Communiqué, Inc. (Feb. 27, 2008) ("Data Communiqué Letter"); Letter of Firehouse Communications LLC (Feb. 29, 2008) ("Firehouse Letter"); Letter of L. A. Schnase (Feb. 26, 2008) ("Schnase Letter"). But see Letter of Kathleen K. Clarke (Mar. 4, 2008) ("Clarke Letter").

36 General Instruction C.3.(c)(ii) of Form N-1A.

intended to provide investors with streamlined disclosure of key mutual fund information at the front of the statutory prospectus, in a standardized order that facilitates comparisons across funds. We are adopting the following amendments to Form N-1A in order to implement the summary section.

1. General Instructions to Form N-1A

We are adopting, substantially as proposed, amendments to the General Instructions to Form N-1A to address the new summary section of the statutory prospectus. These amendments address plain English and organizational requirements.

Plain English

We are amending, as proposed, the General Instructions to state that the summary section of the prospectus must be provided in plain English under rule 421(d) under the Securities Act.[37] Rule 421(d) requires an issuer to use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors sections of its prospectus.[38] The amended instruction will serve as a reminder that the new prospectus summary section is subject to rule 421(d). The use of plain English principles in the new summary section will further our goal of encouraging funds to create useable summaries at the front of their prospectuses. The prospectus, in

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[37] General Instruction B.4.(c) of Form N-1A; rule 421(d) [17 CFR 230.421(d)].

Commenters generally supported the use of plain English in the summary section. See, e.g., AARP Letter, supra note 34; Letter of CFA Institute (Feb. 28, 2008) ("CFA Institute Letter"); Letter of Committee on Federal Regulation of Securities of the American Bar Association's Section of Business Law (Mar. 17, 2008) ("ABA Letter"); Letter of Investment Company Institute and Securities Industry and Financial Markets Association (Feb. 28, 2008) ("ICI and SIFMA Letter").

[38] Rule 421(d) lists the following plain English principles: (1) short sentences; (2) definite, concrete, everyday words; (3) active voice; (4) tabular presentation or bullet lists for complex material, wherever possible; (5) no legal jargon or highly technical business terms; and (6) no multiple negatives.

its entirety, also will remain subject to the requirement that the information be presented in a clear, concise, and understandable manner.[39]

Organizational Requirements

We are also adopting amendments to the organizational requirements of the General Instructions, with one modification to address commenters' suggestions. The amendments will require mutual funds to disclose the summary information in numerical order at the front of the prospectus and not to precede this information with any information other than the cover page or table of contents.[40] Commenters generally supported standardizing the order and content of the summary section, agreeing that a standardized summary section will enhance investor understanding and the ability to compare funds.[41] Information included in the summary section need not be repeated elsewhere in the prospectus. While a fund may continue to include information in the prospectus that is not required, a fund may not include any such additional information in the summary section of the prospectus.[42]

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39 Pursuant to rule 421(b) [17 CFR 230.421(b)], the following standards must be used when preparing prospectuses: (1) present information in clear, concise sections, paragraphs, and sentences; (2) use descriptive headings and subheadings; (3) avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus; and (4) avoid legal and highly technical business terminology. We note that these standards provide funds with flexibility, for example, in determining whether or not to use headings in a question-and-answer format.

40 General Instruction C.3.(a) to Form N-1A.

41 See, e.g., Letter of Evergreen Investments (Feb. 28, 2008) ("Evergreen Letter"); Letter of Financial Services Institute (Feb. 28, 2008) ("Financial Services Institute Letter").

42 General Instruction C.3.(b) of Form N-1A. See, e.g., CFA Institute Letter, supra note 37; Letter of Great-West Retirement Services (Feb. 28, 2008) ("Great-West Letter"); ICI Letter, supra note 34; Letter of The Vanguard Group, Inc. (Feb. 28, 2008) ("Vanguard Letter") (supporting prohibition on including information in the summary section that is not required).

As noted above, we are, with one exception, requiring as proposed that a multiple fund prospectus present the summary information for each fund sequentially and not integrate the information for more than one fund.[43] That is, a multiple fund prospectus will be required to present all of the summary information for a particular fund together, followed by all of the summary information for each additional fund. For example, a multiple fund prospectus will not be permitted to present the investment objectives for several funds followed by the fee tables for several funds. A multiple fund prospectus will also be required to identify clearly the name of the particular fund at the beginning of the summary information for that fund.

Many commenters agreed that multiple fund prospectuses should present the summary information for each fund separately.[44] Some commenters stated that requiring a separate summary for each fund will better achieve the Commission's goal of keeping summaries short which should help facilitate comparisons across funds.[45] Commenters also stated that multiple fund prospectuses often confuse investors and make reviewing key information for a single fund more difficult.[46]

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43 General Instruction C.3.(c)(ii) of Form N-1A. See supra note 36 and accompanying text.

44 See, e.g., CFA Institute Letter, supra note 37; Letter of Coalition of Mutual Fund Investors (Feb. 13, 2008) ("CMFI Letter"); Fund Democracy et al. Letter, supra note 34; Evergreen Letter, supra note 41; MFDF Letter, supra note 34; Letter of the National Association of Personal Financial Advisors (Feb. 28, 2008) ("NAPFA Letter"); Letter of Oppenheimer Funds (Feb. 28, 2008) ("Oppenheimer Letter").

45 See, e.g., Fund Democracy et al. Letter, supra note 34; Data Communiqué Letter, supra note 35. See also ICI Letter, supra note 34 (stating that some of its members believe that requiring a separate summary for each fund will better facilitate the Commission's goals of keeping documents short and facilitating comparisons across funds).

46 See, e.g., Data Communiqué Letter, supra note 35; CMFI Letter, supra note 44; Oppenheimer Letter, supra note 44.

A number of commenters, however, expressed reservations about the Commission's proposal to prohibit multiple fund summary sections, requesting that the Commission permit integrated summaries for multiple funds in at least some circumstances.[47] Some commenters suggested that integrated summary information would allow investors to better compare all funds within a fund family, or at least certain categories of funds within a fund family.[48] Categories of funds cited included international funds, asset allocation funds, and U.S. Treasury Funds.[49] In addition, some commenters argued that prohibiting multiple fund summaries would lead to unnecessary duplication of information and longer statutory prospectuses.[50]

A number of investors in our focus groups expressed the view that multiple fund presentations of mutual fund information could be helpful in facilitating useful comparisons among funds.[51] Some of these investors stated that multiple fund

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47 See, e.g., Letter of AIM Investments (Feb. 27, 2008) ("AIM Letter") (favoring integrated summaries for target date, asset allocation or lifestyle funds, and variable annuity funds); Capital Research Letter, supra note 34 (favoring integrated summaries for target date and variable annuity funds).

48 See, e.g., AIM Letter, supra note 47; Letter of American Century Investments (Feb. 28, 2008) ("American Century Letter"); Clarke Letter, supra note 35; ICI Letter, supra note 34; Letter of Putnam Investments (Feb. 28, 2008) ("Putnam Letter"); Letter of Russell Investments (Feb. 28, 2008) ("Russell Letter").

49 See, e.g., Letter of T. Rowe Price Associates, Inc. (Feb. 28, 2008) ("T. Rowe Letter") (favoring integrated summaries for certain categories of funds and citing focus group research conducted by T. Rowe Price concerning integrated versus single-fund summaries).

50 See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Letter of Dechert LLP (Mar. 3, 2008) ("Dechert Letter"); Putnam Letter, supra note 48; Russell Letter, supra note 48. See also ICI Letter, supra note 34 (members split, with some noting that an integrated summary may be more useful to investors in certain circumstances, in particular for groups of funds an investor may wish to compare, and others believing that a separate document for each fund would better accomplish goals of keeping the document short and facilitating comparisons across funds).

51 See Focus Group Report, supra note 32, at 9.

presentations could be used as a screening tool to determine which funds to research in more detail.[52] Some investors in our focus groups, however, indicated that combining too many funds within a single summary can result in confusing complexity.[53] The investors in our focus groups did not express a consensus on a specific limit on the number of funds or page length that would be appropriate in multiple fund presentations.

While we believe that multiple fund presentations can, in limited circumstances, be useful in helping investors to compare funds, we have determined that prohibiting multiple fund summary sections is more consistent with the goal of achieving concise, readable summaries for investors. The requirement that summary information be separately presented for each fund in a multiple fund prospectus is intended to address the problem of lengthy and complex multiple fund prospectuses in the least intrusive manner possible. Multiple fund prospectuses contribute substantially to prospectus length and complexity, which act as barriers to investor understanding. We have concluded that permitting information for multiple funds to be integrated in the summary section would undermine our goal of providing mutual fund investors with concise and readable key information.

We note, however, that our rules do not restrict in any way the use of multiple fund presentations in advertising and sales materials, whether those materials are provided along with the Summary Prospectus or separately.[54] Funds have complete flexibility to prepare and present comparative information to investors regarding any

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52 See Focus Group Transcripts, supra note 32, at 20.

53 Id. at 19 ("I thought there were too many in the [multiple fund prospectus]. It just really makes your head spin when you have to read all that."), 22, 46.

54 See rule 482 under the Securities Act [17 CFR 230.482] and rule 34b-1 under the Investment Company Act [17 CFR 270.34b-1] (investment company advertising rules).

grouping of multiple funds that they believe is useful, and also to provide automated tools on their Web sites permitting investors to choose which funds to compare. As a result, we do not believe that the prohibition on multiple fund summaries in the statutory prospectus will impair in any significant manner funds' ability to provide useful, comparative information to investors.

We are adopting one exception to the requirement that multiple fund prospectuses not integrate the summary information for more than one fund in order to eliminate duplicative information and reduce prospectus length. Two commenters recommended that the Commission permit summary information that is identical for multiple funds to be presented once, at the end of all the individual summaries within a multiple fund statutory prospectus.[55] We agree with these commenters that permitting integration of information that is likely to be uniform for multiple funds will further our goal of concise, user-friendly summary sections. Therefore, a multiple fund prospectus will be permitted to integrate the information required by any of new Item 6 (purchase and sale of fund shares), Item 7 (tax information), and Item 8 (financial intermediary compensation) if it is identical for all funds covered in the prospectus.[56] This information is often uniform across multiple funds unlike, for example, information about investment objectives, costs, performance, or portfolio managers. If the information required by any of Items 6 through 8 is integrated, the integrated information will be required to immediately follow the separate individual fund summaries containing the other non-integrated information. In addition, a statement containing the following information will be required in each

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55 See Capital Research Letter, supra note 34; ICI Letter, supra note 34.

56 General Instruction C.3.(c)(iii) of Form N-1A. This exception will not be available to Summary Prospectuses delivered pursuant to new rule 498 because a Summary Prospectus may describe only one fund. See discussion infra Part III.B.2.a.

individual fund summary section in the location where the information that is integrated, and presented later, would have appeared.

> "For important information about [purchase and sale of fund shares,] [tax information,] and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

As proposed, the instructions will permit a fund with multiple share classes, each with its own cost structure, to present the summary information separately for each class, to integrate the information for multiple classes, or to use another presentation that is consistent with disclosing the summary information in a standard order at the beginning of the prospectus.[57] Commenters generally supported, or did not express a view with respect to, allowing multiple class summary sections; and some commenters noted that such sections would assist investors in choosing the class most appropriate for their circumstances.[58] We are not requiring the integration of information for multiple classes of a fund, which two commenters argued was important to facilitate cost comparisons.[59] We are retaining flexibility in this area because we believe that whether a multiple class presentation is helpful or overwhelming depends on the particular circumstances. We note, however, that our ongoing interactive data initiative is intended, among other things, to facilitate cost comparisons by investors across multiple classes of a single fund, as well as across different funds.[60]

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57 General Instruction C.3.(c)(ii) of Form N-1A.

58 See, e.g., Clarke Letter, supra note 35; Data Communiqué Letter, supra note 35; Great-West Letter, supra note 42; Oppenheimer Letter, supra note 44.

59 See, e.g., Fund Democracy et al. Letter, supra note 34; Letter of Brock Hastie (Jan. 8, 2008) ("Hastie Letter").

60 See supra note 28 and accompanying text.

Page Limits

As proposed, we are not imposing page limits on the summary section. We emphasize, however, that it is our intent that funds prepare a concise summary (on the order of three or four pages) that will provide key information. Commenters differed regarding whether the Commission should impose page limits on the summary.

Several commenters supported page limits. One commenter expressed concern that, in the absence of a page limit, the summary section would tend to expand over time, which would undermine its usefulness.[61] Another commenter noted that, absent page limits, lengths of summary sections would vary widely, hindering investors' ability to compare funds.[62]

While we share these commenters' concerns, especially with respect to the possibility of summary sections getting longer over time, we believe that these concerns are outweighed by the concerns of other commenters that page limits could constrain appropriate disclosure and lead funds to omit material information.[63] We also agree with a commenter who noted that the prohibition of multiple fund summary sections should help to limit their length.[64]

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61 See Letter of Independent Directors Council (Feb. 15, 2008) ("IDC Letter").

62 See Firehouse Letter, supra note 35. See also Letter of Jeffrey C. Keil (Jan. 9, 2008) ("Keil Letter") (suggesting that summaries might garner more investor attention if limited to two or three pages).

63 See, e.g., Letter of Janus Capital Group (Feb. 28, 2008) ("Janus Letter"); CMFI Letter, supra note 44.

64 See Data Communiqué Letter, supra note 35.

Elimination of Separate Purchase and Redemption Document

As proposed, we are eliminating the provisions of Form N-1A that permit a fund to omit detailed information about purchase and redemption procedures from the prospectus and to provide this information in a separate document that is incorporated into and delivered with the prospectus, as well as a similar provision in the requirements for the statement of additional information ("SAI").[65] We have concluded that this option is unnecessary in light of the new Summary Prospectus which could be used, at a fund's option, along with any additional sales materials, including a document describing purchase and redemption procedures.[66] The elimination of these provisions does not otherwise alter the information about purchase and redemption procedures that must appear in the fund's prospectus and SAI, and this information will continue to be required in those documents.

Variable Contract and Retirement Plan Funds

Finally, we are modifying the proposal to permit funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information required in the new summary section. This modification addresses commenters' concerns that certain information is not relevant to those funds.[67] Specifically, we are amending the General Instructions to Form N-1A to permit funds that are used as investment options for retirement plans and variable insurance contracts

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65 Instruction 6 to current Item 1(b) of Form N-1A; current Item 6(g) of Form N-1A; Instruction to current Item 18(a) of Form N-1A.

66 See discussion infra Part III.B.1. Most commenters did not address this proposed change. But see Clarke Letter, supra note 35 (supporting change); Schnase Letter, supra note 35 (opposing change).

67 See Letter of EQ Advisors Trust/AXA Premier VIP Trust (Feb. 28, 2008) ("EQ/AXA Letter"); Letter of Committee of Annuity Insurers (Feb. 28, 2008) ("CAI Letter").

to modify or omit the information required by new summary section Item 6 (purchase and sale of fund shares).[68] Existing Form N-1A permits funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information regarding the purchase and sale of fund shares that is not relevant in these contexts.[69] The amendment we are making extends the same treatment to the purchase and sale information in the new summary section.

2. Exchange Ticker Symbols

We requested comment on whether we should require or permit a fund to include its ticker symbol in the summary, or on the front or back cover page of the statutory prospectus or SAI or elsewhere. Many commenters suggested that the Commission should require or permit funds to disclose their exchange ticker symbols.[70] We agree with these commenters that requiring exchange ticker symbols to be included in fund disclosure documents would make it easier for investors to find information about particular funds and share classes of funds. Accordingly, we are requiring that a fund include its exchange ticker symbol on the cover pages of the statutory prospectus and SAI.[71] Specifically, a fund will be required to disclose the exchange ticker symbol of the

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68 General Instruction C.3.(d)(i) of Form N-1A.

69 General Instruction C.3.(d)(i) of existing Form N-1A. We note that Item 7 of the summary section, which requires tax information that may not be relevant in the context of retirement plans and variable insurance contracts, expressly states that the disclosures are only required to be made, as applicable.

70 See, e.g., CMFI Letter, supra note 44; Data Communiqué Letter, supra note 35; Firehouse Letter, supra note 35; Hastie Letter, supra note 59; Letter of William E. Kent (Dec. 26, 2007) ("Kent Letter"); NAPFA Letter, supra note 44; Letter of Art Ticknor (Feb. 6, 2008) ("Ticknor Letter").

71 Item 1(a)(2) of Form N-1A; Item 14(a)(2) of Form N-1A. Exchange ticker symbols will also be required on the cover page, or at the beginning of, the Summary Prospectus. Rule 498(b)(1)(ii).

fund's shares or, if the prospectus or SAI relate to one or more classes of the fund's shares, adjacent to each such class, the exchange ticker symbol of that class.

3. Information Required in Summary Section

We are adopting the required content of the summary section substantially as proposed, except that, having considered commenters' concerns and the views of investors expressed in focus groups, we have determined not to require disclosure of a fund's portfolio holdings. The summary section of a mutual fund statutory prospectus will consist of the following information: (1) investment objectives; (2) costs; (3) principal investment strategies, risks, and performance; (4) investment advisers and portfolio managers; (5) brief purchase and sale and tax information; and (6) financial intermediary compensation. These items will appear in the same order that we proposed. We have modified the requirements for some items to address comments and views expressed in the focus groups.

a. Elimination of Proposed Portfolio Holdings Requirement

The Commission has determined not to require the summary section to include the list of the fund's 10 largest holdings which we proposed.[72] As proposed, the top 10 holdings list would have been updated in the statutory prospectus on an annual basis and in the Summary Prospectus on a quarterly basis.[73]

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72 Proposed Item 5 of Form N-1A.

73 Section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)] generally requires that when a prospectus is used more than nine months after the effective date of the registration statement, the information in the prospectus must be as of a date not more than sixteen months prior to such use. The effect of this provision is to require mutual funds to update their prospectuses annually to reflect current cost, performance, and other financial information. See proposed rule 498(b)(2)(iii) (proposed Summary Prospectus quarterly updating requirement).

Commenters were split regarding whether the top 10 portfolio holdings should be required in the summary section. We are persuaded by the commenters who pointed out the limited utility of the proposed top 10 holdings list.[74] Commenters expressed the view that top 10 holdings information may mislead investors because the top 10 holdings may not accurately represent a fund's overall holdings[75] and because the top 10 holdings information may become stale.[76] Commenters also pointed out that portfolio holdings information is already widely available through other sources, such as shareholder reports and other Commission filings,[77] as well as fund Web sites and sales materials.[78]

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74 See, e.g., AIM Letter, supra note 47; Letter of Cornell Securities Law Clinic (Feb. 28, 2008) ("Cornell Law Clinic Letter"); Evergreen Letter, supra note 41; Letter of Foreside Compliance Services, LLC (Feb. 28, 2008) ("Foreside Letter"); Oppenheimer Letter, supra note 44; Russell Letter, supra note 48.

Other commenters supported including the top 10 portfolio holdings in the summary section. See, e.g., CMFI Letter, supra note 44; Data Communiqué Letter, supra note 35; Firehouse Letter, supra note 35; Letter of Jill Gross (Feb. 28, 2008); Letter of Richard K. Hopkins (Feb. 15, 2008) ("Hopkins Letter"); Letter of Richard McCormick (Feb. 11, 2008) ("McCormick Letter"); Letter of William Mahavier (Feb. 10, 2008) ("Mahavier Letter"); Letter of Dan Meador (Feb. 12, 2008); NAPFA Letter, supra note 44; Letter of Bruce R. Bent (Feb. 28, 2008) ("Bent Letter").

75 See, e.g., Dechert Letter, supra note 50 (top 10 holdings information could mislead investors of a diversified fund where top 10 holdings represent a relatively small percentage of the fund's holdings); ICI Letter, supra note 34 (noting that a fund's top 10 holdings may be misleading for funds in a master-feeder structure, funds of funds, fixed income funds, index funds, money market funds, exchange-traded funds, and new funds); Letter of New York City Bar (Feb. 25, 2008) ("NYC Bar Letter") (arguing that for certain types of funds, such as money market funds, fixed income funds, and index funds, top 10 holdings information may be misleading); Letter of Leslie L. Ogg (Feb. 1, 2008) ("Ogg Letter") (noting that top 10 holdings information can be misleading for multi-manager funds, funds of funds, long-short funds, and funds using derivative instruments).

76 See, e.g., AIM Letter, supra note 47; CAI Letter, supra note 67; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Dechert Letter, supra note 50; ICI Letter, supra note 34; IDC Letter, supra note 61; Janus Letter, supra note 63; NYC Bar Letter, supra note 75; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48.

77 Form N-CSR [17 CFR 249.331; 17 CFR 274.128] (form used by investment companies semi-annually to file certified shareholder reports); Form N-Q [17 CFR 249.332; 17 CFR 274.130] (form used by investment companies to file schedule of portfolio holdings for first and third quarters).

We continue to believe that information concerning a fund's portfolio holdings may provide investors with a greater understanding of a fund's stated investment objectives and strategies and may assist investors in making more informed asset allocation decisions. In light of the limited utility of top 10 holdings information, however, and the widespread availability of portfolio holdings information from other sources, we have determined not to require this information in the summary section. Some commenters and investors in our focus groups suggested that we instead require disclosure about the current allocation of a fund's portfolio by asset type, such as a pie chart that would graphically display this information.[79] We have determined not to require this information because we have concluded that it is subject to the same concerns about staleness as top 10 holdings information and because of the widespread availability of portfolio holdings information from other sources. Nonetheless, where a fund's asset allocation strategy is a principal investment strategy of the fund, the fund should clearly disclose this strategy,[80] and we would encourage the use of graphical representations as a potentially helpful communications tool.

In reaching our determination with respect to portfolio holdings information, we carefully considered the views of investors expressed in our focus groups. Many investors in the focus groups expressed significant interest in portfolio holdings information.[81] At the same time, like the commenters, a number of the investors

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78 See, e.g., AIM Letter, supra note 47; EQ/AXA Letter, supra note 67; Evergreen Letter, supra note 41; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.

79 See, e.g., Cornell Law Clinic Letter, supra note 74; Oppenheimer Letter, supra note 44; Focus Group Report, supra note 32, at 6.

80 Items 4(a) and 9 of Form N-1A (requiring disclosure of principal investment strategies).

81 Focus Group Report, supra note 32, at 7; Focus Group Transcripts, supra note 32, at 12.

participating in our focus groups pointed out that top 10 portfolio holdings information changes frequently and can quickly become outdated, and some participants acknowledged that the top 10 holdings information can sometimes account for a relatively small portion of a fund's holdings.[82] We concluded that investors' interest in this information is outweighed by its potential to mislead and confuse in the context of the summary section of a prospectus. Because this information is widely available through other sources, we are persuaded that investors' interest in this information can be satisfied through these other sources.

b. Order of Information

We are adopting the order of the information required in the summary section, as proposed. This includes moving the fee table forward from its current location, which follows information about investment strategies, risks, and past performance. We continue to believe that the change to the location of the fee table will enhance the prominence of this information, which is important to address continuing concerns about investor understanding of mutual fund costs.[83] Several commenters agreed that relocation of the fee table will place fee information in a more prominent location and encourage investors to give greater attention to costs and cost comparisons.[84] While

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82 Focus Group Report, supra note 32, at 7; Focus Group Transcripts, supra note 32, at 13-14, 78.

83 See Barbara Roper, Director of Investor Protection, Consumer Federation of America, June 12 Roundtable Transcript, supra note 18, at 21; James J. Choi, David Laibson, & Brigitte C. Madrian, National Bureau of Economic Research, Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds, at 6 (May 2006), available at http://www.nber.org/papers/w12261.pdf.; Focus Group Transcripts, supra note 32, at 6 ("[The hypothetical summary prospectus] shows the fee right up there, what they charge, so that would appeal to me.").

84 See, e.g., Letter of Roy J. Biegel (Feb. 14, 2008) ("Biegel Letter"); CFA Institute Letter, supra note 37; Foreside Letter, supra note 74; Letter of Fund Democracy and Consumer

several commenters suggested alternative orders for the information in the summary section, there was no consensus by commenters regarding any alternative.[85]

A number of commenters, largely from the fund industry, opposed relocating the fee table. These commenters argued that moving the fee table forward inappropriately overemphasizes costs over other more important information and that the fee table should not come between investment objectives and principal investment strategies and risks.[86] Some of these commenters argued that the fee table should not be moved forward, because it is important for investors to first and foremost understand a fund and its risks, and that a fund's objectives, strategies, and risks provide necessary context for fees. Some commenters also argued that moving the fee table forward is unnecessary because the short length of the summary section will make the fee table sufficiently prominent.

We are not persuaded by these commenters. We continue to believe, along with a number of commenters, that placement of the fee table in a more prominent location will encourage investors to give greater attention to costs. The fee table and example are designed to help investors understand the costs of investing in a fund and compare those costs with the costs of other funds. Placing the fee table and example at the front of the

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Federation of America (Apr. 17, 2008); NAPFA Letter, supra note 44; Letter of Charles Sikorovsky (Feb. 29, 2008) ("Sikorovsky Letter"). See also Focus Group Transcripts, supra note 32, at 10 (investors expressed view that fund costs are important); Letter of Investment Company Institute (Mar. 14, 2008) ("ICI Survey") (finding that 95% of respondents believed that fees are important).

85 See, e.g., Letter of Ward C. Bourn (Feb. 27, 2008); Capital Research Letter, supra note 34; Evergreen Letter, supra note 41; Financial Services Institute Letter, supra note 41; Vanguard Letter, supra note 42.

86 See, e.g., AIM Letter, supra note 47; Evergreen Letter, supra note 41; Letter of Fidelity Investments (Feb. 28, 2008) ("Fidelity Letter"); ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.

summary section reflects the importance of costs to an investment decision.[87] Moving the fee table forward also eliminates the possibility that the fee table could be obscured by other information.[88]

c. Investment Objectives and Goals

We are adopting, as proposed, the requirement that the summary section begin with disclosure of a fund's investment objectives or goals, which commenters generally supported.[89] As proposed, a fund also will be permitted to identify its type or category (e.g., that it is a money market fund or balanced fund).[90]

d. Fee Table

We are adopting, with modifications to address commenters' concerns and views expressed by investors in the focus groups, the fee table and example. The fee table and example disclose the costs of investing and immediately follow the fund's investment objectives.[91]

Breakpoint Discounts

We are requiring, substantially as proposed, that mutual funds that offer discounts on front-end sales charges for volume purchases (so-called "breakpoint discounts")

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87 For example, a 1% increase in annual fees reduces an investor's return by approximately 18% over 20 years.

88 See Sikorovsky Letter, supra note 84 (stating that if an investment manager can in any way "hide" fees from an investor, the document has failed to fulfill its function).

89 See, e.g., AARP Letter, supra note 34; Firehouse Letter, supra note 35; ICI and SIFMA Letter, supra note 37; Letter of Christine A. Nelson (Feb. 12, 2008); Schnase Letter, supra note 35. See also ICI Survey, supra note 84 (providing survey results that found investment objectives was one of the most important pieces of information to investors).

90 Item 2 of Form N-1A.

91 Item 3 of Form N-1A.

include brief narrative disclosure alerting investors to the availability of those discounts.[92] Commenters generally supported the disclosure about breakpoint discounts, although many commenters, as well as focus group investors, provided suggestions for revising the narrative proposed.[93] We are modifying the proposal in two ways to address these comments.

First, we are adding to the required narrative a description of where investors can find additional information regarding breakpoint discounts.[94] Specifically, the narrative will be required to state that further information is available from the investor's financial professional, as well as identify the section heading and page number of the fund's prospectus and SAI where more information can be found. This information is intended to address the views of both commenters and investors in the focus groups that it would be helpful for more detailed information about breakpoint discounts to be readily available to investors.[95]

Second, we are clarifying the instruction that the dollar level at which investors may qualify for breakpoint discounts that is required to be disclosed in the new item is the minimum level of investment required to qualify for a discount as disclosed in the

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92 Item 3 of Form N-1A; Instruction 1(b) to Item 3 of Form N-1A.

93 See, e.g., AIM Letter, supra note 47; CFA Institute Letter, supra note 37; Fund Democracy et al. Letter, supra note 34; Letter of Manuela A. De Leon (Feb. 7, 2008); ICI Letter, supra note 34; Keil Letter, supra note 62; NAPFA Letter, supra note 44; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48; Focus Group Report, supra note 32, at 8.

94 Item 3 of Form N-1A.

95 See, e.g., CMFI Letter, supra note 44 (summary should indicate where additional information about breakpoint discounts is available); NAPFA Letter, supra note 44 (same); Focus Group Transcripts, supra note 32, at 17 (participant observes that "I'll go to the long-form and look that up and then make my decision.").

table required by current Item 7(a)(1) of Form N-1A.[96] This change makes clear that the required dollar threshold to be disclosed is the same as disclosure that is already required in Form N-1A. This change, together with the added narrative about additional information, addresses commenters' concerns that the breakpoints disclosure does not capture the complexity and variety of policies regarding breakpoint discounts.[97]

Parenthetical to "Annual Fund Operating Expenses"

We are adopting, substantially as proposed, revisions to the heading "Annual Fund Operating Expenses" in the fee table. Specifically, we are revising the parenthetical following the heading to read "expenses that you pay each year as a percentage of the value of your investment" in place of "expenses that are deducted from Fund assets."[98] In recent years, we have taken significant steps to address concerns that investors do not understand that they pay costs every year when they invest in mutual funds, including requiring disclosure of these costs in shareholder reports.[99] Our revision further addresses those concerns by making clear that the expenses in question are paid by investors as a percentage of the value of their investments in the fund.

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96 Instruction 1(b) to Item 3 of Form N-1A. Item 7 of Form N-1A is being renumbered as Item 12 in this rulemaking..

97 See, e.g., AIM Letter, supra note 47; ICI Letter, supra note 34; Russell Letter, supra note 48; Letter of Securities Industry and Financial Markets Association (Feb. 28, 2008) ("SIFMA Letter").

98 Item 3 of Form N-1A.

99 Item 27(d)(1) of Form N-1A; Investment Company Act Release No. 26372 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)] (adopting disclosure of costs in shareholder reports). See also General Accounting Office Report on Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition, at 66-81 (June 2000), available at http://www.gao.gov/archive/2000/gg00126.pdf (discussing lack of investor awareness of the fees they pay and investor focus on mutual fund sales charges rather than recurring fees).

Many commenters supported the Commission's proposed revision.[100] We have deleted the word "ongoing" from the beginning of the parenthetical language to address commenters' concerns that this term incorrectly suggests that fund operating expenses are the same each year.[101] We are not modifying the parenthetical to address the views of some industry commenters that the statement incorrectly implies that shareholders directly pay fund expenses, when in fact expenses are paid out of fund assets.[102] The purpose of the revision is to make clear to investors that they, in fact, bear these expenses, and the proposed language conveys this fact. Our conclusion is supported by commenters representing investor groups.[103]

Portfolio Turnover Rate

We are adopting, with two modifications, the requirement that funds, other than money market funds, include brief disclosure regarding portfolio turnover immediately following the fee table example.[104] A fund will be required to disclose its portfolio turnover rate for the most recent fiscal year as a percentage of the average value of its portfolio. This numerical disclosure will be accompanied by a brief explanation of the effect of portfolio turnover on transaction costs and fund performance. Some concerns

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100 See, e.g., CFA Institute Letter, supra note 37; Clarke Letter, supra note 35; Fund Democracy et al. Letter, supra note 34.

101 See, e.g., CFA Institute Letter, supra note 37; Clarke Letter, supra note 35; Fund Democracy et al. Letter, supra note 34; Evergreen Letter, supra note 41; Letter of Fenimore Asset Management (Feb. 28, 2008); Fidelity Letter, supra note 86; MFDF Letter, supra note 34; Oppenheimer Letter, supra note 44; T. Rowe Letter, supra note 49.

102 See, e.g., Evergreen Letter, supra note 41; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; Putnam Letter, supra note 48; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.

103 See Fund Democracy et al. Letter, supra note 34.

104 Instruction 5 to Item 3 of Form N-1A.

have been expressed in recent years regarding the degree to which investors understand the effect of portfolio turnover; and the resulting transaction costs, on fund expenses and performance.[105] The requirement to provide brief portfolio turnover disclosure in the summary section of the prospectus is intended to address these concerns, and the proposed disclosure received support from a significant number of commenters.[106] Because we believe that it is important to address investors' lack of understanding of the effect of portfolio turnover and transaction costs on fund expenses and performance, we disagree with commenters opposing the disclosure of portfolio turnover rate on the grounds that such information is too complicated or unnecessary for the summary section.[107]

We are modifying the proposed required explanation of the effect of portfolio turnover to require that the explanation also address the adverse tax consequences that may result from a higher portfolio turnover rate when fund shares are held in a taxable account. We agree with commenters who suggested that adverse tax consequences, as

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105 See Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74820 (Dec. 24, 2003)] (request for comment regarding ways to improve disclosure of transaction costs); Report of the Mutual Fund Task Force on Soft Dollars and Portfolio Transaction Costs (Nov. 11, 2004), available at http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p012356.pdf.

106 See, e.g., Biegel Letter, supra note 84; CFA Institute Letter, supra note 37; CMFI Letter, supra note 44; Fund Democracy et al. Letter, supra note 34; IDC Letter, supra note 61; Mahavier Letter, supra note 74; NAPFA Letter, supra note 44; Schnase Letter, supra note 35; Vanguard Letter, supra note 42. See also ICI Letter, supra note 34 (stating that it does not oppose the disclosure).

107 See, e.g., American Century Letter, supra note 48; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Evergreen Letter, supra note 41; Foreside Letter, supra note 74; McCormick Letter, supra note 74; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48.

well as higher transaction costs, should be expressly addressed by the explanation.[108] We are also making a technical revision to the final sentence of the proposed required explanation.[109]

We have determined not to adopt two significant suggestions that were made by commenters: first, that we require the impact of transaction costs to be reflected in a fund's expense ratio in the fee table and, second, that we require disclosure of portfolio turnover rates over a period greater than one year. While we believe that both of these suggestions have considerable merit, we have concluded that it is not feasible to implement either at the present time as discussed further below.

Several commenters expressed the view that the Commission should require that transaction costs be reflected in a fund's expense ratio in the fee table and that this disclosure would be more meaningful to investors than the rate of portfolio turnover.[110] The comments on this rulemaking, however, do not provide an adequate basis for prescribing a specific and accurate methodology for reflecting transaction costs in a fund's expense ratio.[111] We do agree with the commenters that portfolio turnover rate is

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108 See Fund Democracy et al. Letter, supra note 34; Letter from Representative Donald A. Manzullo (Feb. 26, 2008) ("Manzullo Letter").

109 Item 3 of Form N-1A. We are deleting the reference to portfolio turnover rate as a percentage of the average value of the fund's "whole" portfolio in the explanation to reflect the fact that the rate is calculated without reference to securities whose maturities at the time of acquisition are one year or less. See Instruction 4(d)(ii) to current Item 8(a) of Form N-1A (describing how to calculate portfolio turnover rate; current Item 8 is being renumbered as Item 13).

110 See, e.g., Fund Democracy et al. Letter, supra note 34; Letter from Representative George Miller, Senator Edward M. Kennedy, Representative Robert E. Andrews, Senator Tom Harkin, and Senator Herb Kohl (Mar. 13, 2008) ("Miller Letter").

111 In addition, in 2003 the Commission issued a concept release that sought public comment on a number of issues related to the disclosure of mutual fund transaction costs. See Investment Company Act Release No. 26313, supra note 105, 68 FR at 74820. While

an imperfect measure of portfolio transaction costs. While a higher portfolio turnover rate tends to result in higher transaction costs and a lower portfolio turnover rate tends to result in lower transaction costs, there is not necessarily a direct correlation between portfolio turnover rate and portfolio transaction costs. Nonetheless, in the absence of a basis for prescribing a better measure, we believe that portfolio turnover rate, though imperfect, is an appropriate indicator of transaction costs for purposes of the summary section.

A number of commenters argued that disclosing a portfolio turnover rate over a one-year period would not yield a representative portfolio turnover rate because portfolio turnover rates vary significantly over time depending on a variety of factors, including the need to meet redemption requests, unexpected cash inflows due to sharp swings in markets, or the occurrence of a significant event not likely to repeat in future years, such as a fund merger or a new portfolio manager restructuring the fund's holdings.[112] These commenters suggested that the Commission address this concern by, for example, requiring funds to disclose year-by-year turnover rates for a longer period (e.g., 5-10 years) or an average turnover rate over a longer period of time (e.g., five years).[113] We believe that requiring year-by-year turnover rates for multiple years in the summary section would not further our goal of providing concise, user-friendly disclosure, particularly in light of the fact that there is not necessarily a direct correlation between

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most commenters who responded to the concept release felt that there should be greater transparency of mutual fund transaction costs, there was a wide range of opinions on what should be disclosed.

112 See, e.g., CMFI Letter, supra note 44; Firehouse Letter, supra note 35; IDC Letter, supra note 61.

113 See, e.g., CMFI Letter, supra note 44; Mahavier Letter, supra note 74.

portfolio turnover and transaction costs. We note that portfolio turnover rates for each of the past five years are already required elsewhere in the prospectus.[114] We do not believe that there is a sufficient basis in the comments to require disclosure of an average turnover rate over a longer period of time (e.g., five years). Doing so would require us to address a number of questions that have not been subject to adequate comment in this rulemaking, including devising a calculation methodology and addressing questions of comparability across funds that have been in existence for different periods of time.

Expense Reimbursement and Fee Waiver Arrangements

Finally, we are adopting, with modifications to address commenters' recommendations, the proposed amendments to the requirement that a fund disclose in its fee table gross operating expenses that do not reflect the effect of expense reimbursement or fee waiver arrangements, which result in reduced expenses being paid by the fund.[115] The adopted amendments will permit a fund to place two additional captions directly below the "Total Annual Fund Operating Expenses" caption in cases where there are expense reimbursement or fee waiver arrangements that will reduce any fund operating expenses for no less than one year from the effective date of the fund's registration statement.[116] We have eliminated the proposed requirement that the reimbursement or

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114 Item 13(a) of Form N-1A.

115 Instruction 3(d)(i) and 6(a) to Item 3 of Form N-1A. In an expense reimbursement arrangement, the adviser reimburses the fund for expenses incurred. Under a fee waiver arrangement, the adviser agrees to waive a portion of its fees in order to limit fund expenses.

116 Instruction 3(e) to Item 3 of Form N-1A. A fund may not include the additional captions if the expense reimbursement or fee waiver arrangement may be terminated without agreement of the fund's board of directors (e.g., unilaterally by the fund's investment adviser) during the one-year period. If a fee waiver or expense reimbursement arrangement, in fact, terminates less than a year after the effective date of a fund's registration statement, the fund generally would be required to supplement or "sticker" its

waiver arrangement has reduced operating expenses in the past, as suggested by two commenters, because this is irrelevant to the impact that the arrangements will have in the future.[117] The purpose of the permitted line items is to show investors how the arrangements will affect expenses in the future and not how they have affected expenses in the past.[118]

One caption will show the amount of the expense reimbursement or fee waiver, and a second caption will show the fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. Funds that disclose these arrangements will also be required to disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances. We are adding an express requirement that the expected termination date of the arrangement be disclosed in order to address a commenter's concern that investors should be informed in cases where the commitment on a fee waiver becomes shorter than one year.[119]

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prospectus to reflect the termination. The "sticker" would be filed with the Commission in accordance with rule 497 under the Securities Act.

117 Instruction 3(e) to Item 3. We are also making a similar change in the instructions to the fee table example. Instruction 4(a) to Item 3. See, e.g., Dechert Letter, supra note 50; Evergreen Letter, supra note 41.

118 Because expense reimbursement and fee waiver arrangements of new funds will be disclosed in the same manner as existing funds as a result of the elimination of the proposed requirement described in the text, we are eliminating current Instruction 5(b) (renumbered as Instruction 6(b) in the Proposing Release) to Item 3 of Form N-1A, which pertains to new funds, rather than adopting the proposed revision to the Instruction.

119 See, e.g., Fund Democracy et al. Letter, supra note 34.

In computing the fee table example, a fund will be permitted to reflect any expense reimbursement or fee waiver arrangements that will reduce any operating expenses for no less than one year from the effective date of the fund's registration statement.[120] This adjustment may be reflected only in the periods for which the expense reimbursement or fee waiver arrangement is expected to continue. For example, if such an arrangement were expected to continue for one year, then, in the computation of 10-year expenses in the fee table example, the arrangement could only be reflected in the first of the 10 years.[121]

Commenters made several suggestions with respect to cost disclosure that we have determined not to implement at this time. First, a number of commenters suggested that the fee table in the summary section should simply disclose the total fees and expenses and should omit certain line item breakdowns of expenses that are currently required in the statutory prospectus.[122] Commenters argued that a more abbreviated presentation, such as a fund's total expense ratio, is preferable because they argued that

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120 Instruction 4(a) to Item 3 of Form N-1A. We have modified this instruction from the proposal to eliminate the requirement that the arrangement has reduced fund operating expenses during the most recently completed calendar year. This modification is consistent with the modification that is described at notes 117 and 118 and the accompanying text.

We are also adopting, as proposed, a technical amendment to the instructions to the expense example to eliminate language permitting funds to reflect the impact of the amortization of initial organization expenses in the expense example numbers. Id. This language is unnecessary because initial organization expenses must be expensed as incurred and may no longer be capitalized. See American Institute of Certified Public Accountants, Statement of Position 98-5, Reporting on the Costs of Start-Up Activities (Apr. 3, 1998).

121 A fund may not reflect the arrangement in any period during which the arrangement may be terminated without agreement of the fund's board of directors (e.g., unilaterally by the fund's investment adviser).

122 See, e.g., Capital Research Letter, supra note 34; Evergreen Letter, supra note 41; Fund Democracy et al. Letter, supra note 34.

the current breakdown of fees is not crucial information to an investor's investment decision.[123] We believe that this idea deserves further consideration, and we will consider it for possible future rulemaking.

Second, some commenters suggested that we consider alternative terms to describe sales loads or rule 12b-1 fees[124] because the terms are not easily understood by most investors.[125] We have concluded that it is more appropriate to consider these changes in the context of a full reconsideration of sales charges and rule 12b-1 rather than in the current rulemaking.[126]

Finally, some commenters suggested that the fee table require some form of comparison of the fund's fees to a relevant benchmark based on the fees of similar funds.[127] The Commission shares the commenters' view that the ability to compare fees across mutual funds is extremely important to investors. To facilitate this comparison, we have designed the summary section to provide investors with key information in a standardized order. We also note that the Commission's ongoing interactive data initiative is intended to provide investors and other users with the tools necessary to

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123 See Fund Democracy et al. Letter, supra note 34.

124 "Rule 12b-1 fees" or "12b-1 fees" are fees paid out of fund assets pursuant to a distribution plan adopted under rule 12b-1 under the Investment Company Act [17 CFR 270.12b-1].

125 See, e.g., Miller Letter, supra note 110; CFA Institute Letter, supra note 37; Manzullo Letter, supra note 108; Letter of Investor Rights Clinic at Pace University School of Law (Feb. 28, 2008) ("Pace Letter").

126 The Commission last year hosted a roundtable that brought together representatives from mutual funds, financial services companies, and investor advocacy groups to discuss issues relating to rule 12b-1. See Commission Roundtable on Rule 12b-1 (Jun. 19, 2007) available at http://www.sec.gov/spotlight/rule12b-1.htm. Following the roundtable, we sought public comment on these topics and have received almost 1,500 comment letters.

127 See, e.g., AARP Letter, supra note 34; Fund Democracy et al. Letter, supra note 34; Letter of Gary M. Keenan (Feb. 14, 2008).

facilitate comparisons of fee information. The Commission recently proposed rules that would, if adopted, require mutual funds to file the information in their fee tables in an interactive data format that would facilitate automated analysis of the information and comparison to other funds.[128] The interactive data format would allow users of fee table information to download cost and performance information directly into spreadsheets and analyze it using commercial off-the-shelf software.

e. Investments, Risks, and Performance

Following the fee table and example, we are requiring, substantially as proposed, that a fund disclose its principal investment strategies and risks.[129] This includes the current bar chart and table illustrating the variability of returns and showing the fund's past performance.

We are modifying the narrative that is required to accompany the bar chart and performance table in one respect to address the views expressed by both focus group investors and commenters. A fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number will be required to include a statement explaining this and providing the Web site address and/or telephone number.[130] A number of investors in focus groups expressed the view that the availability of updated performance information, particularly at a Web site, would be

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128 See Investment Company Act Release No. 28298, supra note 28, 73 FR at 35442.

129 Item 4 of Form N-1A. To conform to other changes we are adopting to Form N-1A, the Instructions to Item 4 contain technical revisions that (1) amend cross-references to other Items in Form N-1A; and (2) eliminate language related to the presentation of performance information for more than one fund, given the requirement that information for each fund be presented separately. Instructions 2(e) and 3 to Item 4(b)(2) of Form N-1A.

130 Item 4(b)(2)(i) of Form N-1A.

helpful.[131] In addition, many industry commenters noted that funds routinely make updated performance information available to investors either by Internet Web site or by telephone and suggested that the summary section direct investors to this information.[132] Particularly in light of our determination not to require quarterly updating of the Summary Prospectus, which is discussed below,[133] we believe that it will be helpful to investors for the summary section to indicate where updated performance information may be found.

We are not modifying the required bar chart and performance table to add additional comparative information as suggested by several commenters.[134] Currently, funds are required to include an appropriate broad-based securities market index in the performance table.[135] We have determined not to require additional comparative performance information at this time because we are concerned that it would tend to undermine our goal of a concise, user-friendly summary of key information by contributing to the length and complexity of the summary section. Further, as with cost

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131 See Focus Group Report, supra note 32, at 11; see, e.g., Focus Group Transcripts, supra note 32, at 49, 78.

132 See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Capital Research Letter, supra note 34; Fidelity Letter, supra note 86; ICI Letter, supra note 34; Janus Letter, supra note 63; Oppenheimer Letter, supra note 44; Putnam Letter, supra note 48; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.

133 See discussion infra Part III.B.2.c.

134 See, e.g., Letter of Scott Hastings (Feb. 11, 2008) (suggesting comparative disclosure of the portfolio manager's stated benchmark); Morningstar Letter, supra note 34 (same).

135 Current Item 2(c)(2)(iii) of Form N-1A; Instruction 5 to current Item 22(b)(7) of Form N-1A. A fund is also permitted to include information for one or more other indexes. Instruction 6 to current Item 22(b)(7) of Form N-1A. If an additional index is included, a fund is required to disclose information about the additional index in the narrative explanation accompanying the bar chart and table (e.g., by stating that the information shows how the fund's performance compares with the returns of an index of funds with similar investment objectives).

information,[136] we believe that it is preferable for investors and other users of the prospectus to be given the flexibility to make a variety of performance benchmark comparisons. Our ongoing interactive data initiative is intended to provide the tools necessary to facilitate dynamic comparisons of this type, and we note that the information in the bar chart and performance table is covered by our recently proposed rules that would, if adopted, require mutual funds to file information in an interactive data format.[137]

f. Management

We are adopting, as proposed, the requirement that the summary section include the name of each investment adviser and sub-adviser of the fund, followed by the name, title, and length of service of the fund's portfolio managers.[138] A fund will not be required to identify a sub-adviser whose sole responsibility is limited to day-to-day management of cash instruments unless the fund is a money market fund or other fund with a principal investment strategy of regularly holding cash instruments.[139] Also, a fund having three or more sub-advisers, each of which manages a portion of the fund's portfolio, will not be required to identify each sub-adviser, except that the fund will be required to identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the fund's net assets. For this purpose, a

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136 See supra note 127 and accompanying text.

137 See Investment Company Act Release No. 28298, supra note 28, 73 FR at 35442.

138 Item 5 of Form N-1A. Additional disclosures regarding investment advisers and portfolio managers that are currently required in the prospectus will continue to be required, but not in the summary section. Item 10(a) of Form N-1A.

139 Instruction 1 to Item 5(a) of Form N-1A. A fund will continue to be required to provide the name, address, and experience of all sub-advisers elsewhere in the prospectus. Item 10(a)(1)(i) of Form N-1A.

significant portion of a fund's net assets generally will be deemed to be 30% or more of the fund's net assets.[140] The portfolio managers required to be listed will be the same ones with respect to which information is currently required in the prospectus.[141]

Several commenters opposed requiring funds to disclose portfolio managers.[142] Two of these commenters argued that the identity and length of service of portfolio managers do not rise to the level of importance necessary to warrant inclusion in the summary.[143] However, the Commission continues to believe, along with other commenters,[144] that investors in a fund should be provided basic information about the individuals who significantly affect the fund's investment operations.

Some commenters noted that funds are often managed by teams and that disclosing the individuals making up such teams would make the summary section too long and would not add substantive disclosure.[145] We note that, as is currently the case, disclosure will be required only with respect to the members of a management team who are jointly and primarily responsible for the day-to-day management of the fund's

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140 Instruction 2 to Item 5(a) of Form N-1A.

141 Item 10(a)(2) of Form N-1A.

142 See, e.g., Capital Research Letter, supra note 34; ICI Letter, supra note 34; Vanguard Letter, supra note 42.

143 See ICI Letter, supra note 34; Russell Letter, supra note 48.

144 See, e.g., AARP Letter, supra note 34; Evergreen Letter, supra note 41; Financial Services Institute Letter, supra note 41. See also Focus Group Transcripts, supra note 32, at 11; id. at 30-31 (importance of fund managers); ICI Survey, supra note 84, at 8 (61% of respondents believed that the name of the portfolio manager was very important or somewhat important).

145 See, e.g., Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Ogg Letter, supra note 75.

portfolio.[146] We agree with other commenters that investors have the same interest in the identity of the individuals who are primarily responsible for management, regardless of whether a fund is managed by an individual portfolio manager or a team.[147]

g. Purchase and Sale of Fund Shares

We are adopting, with modifications to address exchange-traded funds,[148] the proposed requirement that the summary section disclose the fund's minimum initial or subsequent investment requirements and the fact that the fund's shares are redeemable, and identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer).[149] Commenters generally did not express a view with respect to this requirement.[150]

h. Tax Information

We are adopting, as proposed, the requirements for tax information in the summary section. A fund will be required to state, as applicable, that it intends to make distributions that may be taxed as ordinary income or capital gains or that the fund

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146 Instruction 2 to Item 5(b) of Form N-1A. In addition, if more than five persons are jointly and primarily responsible for the day-to-day management of a fund's portfolio, the fund need only provide the required information for the five persons with the most significant responsibility.

147 See Evergreen Letter, supra note 41; Keil Letter, supra note 62.

148 See discussion infra Part III.A.4. We are also making a technical amendment to current Item 6(b) of Form N-1A (which is being renumbered as Item 11(b)) to remove the requirement to disclose a fund's minimum initial or subsequent investment requirements because we have added this requirement to Item 6(a) of the summary section.

149 Item 6 of Form N-1A. We are modifying the proposal to permit funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit this information. See supra note 68 and accompanying text.

150 Three commenters supported the proposal. See Letter of Alison W. Beirlein (Feb. 26, 2008); Foreside Letter, supra note 74; Schnase Letter, supra note 35. Three commenters opposed the proposal. See Bent Letter, supra note 74; Clarke Letter, supra note 35; Letter of MFS Investment Management (Feb. 28, 2008) ("MFS Letter").

intends to distribute tax-exempt income. A fund that holds itself out as investing in securities generating tax-exempt income will be required to provide, as applicable, a general statement to the effect that a portion of the fund's distributions may be subject to federal income tax.[151] Commenters generally expressed no views on these requirements.[152]

i. Financial Intermediary Compensation

The Commission is adopting the proposed requirement that the summary section of the prospectus conclude with disclosure regarding financial intermediary compensation. Commenters generally supported this requirement,[153] and we are modifying the requirement in two ways to address views expressed during investor focus groups and the concerns of commenters. Specifically, we are requiring the following statement, which could be modified provided that the modified statement contains comparable information:[154]

> "Payments to Broker-Dealers and Other Financial Intermediaries
>
> If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and

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151 Item 7 of Form N-1A.

152 One commenter opposed mandating the tax information. See Clarke Letter, supra note 35.

153 See, e.g., Data Communiqué Letter, supra note 35; Firehouse Letter, supra note 35; Fund Democracy et al. Letter, supra note 34; ICI Letter, supra note 34; Keil Letter, supra note 62; NAPFA Letter, supra note 44; Schnase Letter, supra note 35; SIFMA Letter, supra note 97; Letter of USAA Investment Management Company (Feb. 28, 2008) ("USAA Letter"); Vanguard Letter, supra note 42; Letter of Wachovia Securities, LLC (Aug. 29, 2008). But see Letter of Capital Research and Management Company (Aug. 29, 2008) (opposing the financial intermediary disclosure requirement).

154 Item 8 of Form N-1A.

your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."

This disclosure will be new to fund prospectuses and is intended to identify the existence of compensation arrangements with selling broker-dealers or other financial intermediaries, alert investors to the potential conflicts of interest arising from these arrangements, and direct investors to their salesperson or the financial intermediary's Web site for further information. It is intended to address, in part, concerns that mutual fund investors lack adequate information about certain distribution-related costs that create conflicts for broker-dealers and their associated persons.[155]

We have added a provision permitting a fund to omit the financial intermediary disclosure if neither the fund nor any of its related companies pay financial intermediaries for the sale of fund shares or related services.[156] This addresses the concerns of a number of commenters who expressed the view that the Commission should not require the narrative disclosure from funds to which the disclosure does not apply.[157] According to

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155 The Commission has recognized these concerns in a separate initiative in which the Commission proposed to require, among other things, disclosure of mutual fund distribution-related costs and conflicts of interest by selling broker-dealers and other financial intermediaries at the point of sale. Securities Act Release No. 8544 (Feb. 28, 2005) [70 FR 10521 (Mar. 4, 2005)]; Securities Act Release No. 8358 (Jan. 29, 2004) [69 FR 6438 (Feb. 10, 2004)]. One commenter to that proposal recommended use of a short-form "profile plus" disclosure document that would include, among other things, basic information about such potential conflicts of interest. See Letter of NASD (Mar. 31, 2005) available at http://www.sec.gov/rules/proposed/s70604/nasd033005.pdf. We intend to consider additional steps to enhance investor access to information prior to making an investment decision. See infra notes 200 and 201 and accompanying text.

156 Item 8 of Form N-1A.

157 See, e.g., CAI Letter, supra note 67; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; T. Rowe Letter, supra note 49; USAA Letter, supra note 153; Vanguard Letter, supra note 42. We note that Item 8 permits a fund to modify the narrative statement provided that the modified statement contains comparable information. For example, a fund that is offered as an underlying investment option for a variable annuity contract could modify the narrative statement to reflect payments made to the sponsoring insurance company for distribution and other services.

one commenter, such funds include, for example, no-load funds and funds sold directly to investors.[158]

We have also modified the proposed statement to clarify that payments to a broker-dealer or other financial intermediary may create a conflict of interest by influencing the broker-dealer or other intermediary to recommend a fund over another investment. This modification, made in response to investor comments from our focus groups, is intended to increase awareness of potential conflicts of interest.[159] We are, therefore, revising the narrative to expressly notify investors that a conflict of interest may exist with respect to the broker-dealer's recommendation.

We have determined not to add a requirement that the disclosure include standardized language enumerating the types of compensation that may be provided to financial intermediaries, as suggested by one commenter.[160] Rather, we are adopting a statement that will alert investors generally to the payment of compensation and the potential conflicts arising from that payment. An investor could then obtain further detail from his or her salesperson or the intermediary's Web site. As discussed further below, we intend to consider additional steps in the future that would further enhance investors'

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158 See ICI Letter, supra note 34. We note, however, that no-load funds and directly-sold funds will be required to include the narrative disclosure in certain circumstances. For example, the disclosure will be required if a no-load fund pays servicing fees to a fund supermarket.

159 See Focus Group Report, supra note 32, at 8 (stating that participants felt that new investors may not be aware of the potential conflict of interest); Focus Group Transcripts, supra note 32, at 16, 41.

160 See NAPFA Letter, supra note 44 (requesting standardized language describing possible forms of compensation, such as surrender fees, payment for shelf space, commissions paid for fund transactions, principal mark-ups and mark-downs, fees derived from bid-ask spreads, and payments for marketing support and/or education of registered representatives).

access to information about broker and intermediary compensation and conflicts of interest.

4. Exchange-Traded Funds

In March of this year, the Commission proposed several amendments to Form N-1A to accommodate the use of the form by ETFs.[161] Most ETFs are organized and registered as open-end funds. Unlike traditional mutual funds, however, they sell and redeem individual shares ("ETF shares") only in large aggregations called "creation units" to certain financial institutions. ETFs register offerings and sales of ETF shares under the Securities Act and list their shares for trading under the Securities Exchange Act of 1934 ("Exchange Act").[162] As with any listed security, investors trade ETF shares at market prices.

The proposed amendments for ETF prospectuses were designed to meet the needs of investors (including retail investors) who purchase ETF shares in secondary market transactions rather than financial institutions that purchase creation units directly from the ETF. The proposed amendments for ETF prospectuses also addressed the need to modify the summary section of ETF prospectuses to include the amended ETF disclosures. Today, we are adopting the proposed amendments for ETF prospectuses with changes to

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161 See ETF Proposing Release, supra note 14, 73 FR at 14618.

162 For a description of how ETFs operate, see id. at 14620-21. ETFs currently operate pursuant to exemptive orders granted by the Commission. The final amendments define an ETF as a fund or class of a fund, the shares of which are traded on a national securities exchange, and that has formed and operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission. General Instruction A of Form N-1A. The final ETF definition in Form N-1A eliminates from the proposed definition the cross-reference to proposed rule 6c-11, which, if adopted, would codify many of the exemptive orders granted to ETFs. See ETF Proposing Release, supra note 14, 73 FR at 14621-30. We have made this technical change to the ETF definition because the Commission has not adopted proposed rule 6c-11.

respond to issues raised by commenters on the summary prospectus proposing release and the ETF proposing release.[163]

a. Purchasing and Redeeming Shares

We are amending Form N-1A to eliminate the requirement that ETF prospectuses disclose information on how to buy and redeem shares directly from the ETF because it is not relevant to investors who are secondary market purchasers of ETF shares.[164] We proposed to require ETF prospectuses to state the number of shares contained in a creation unit (i.e., the aggregate number of shares an ETF will issue or that is necessary to redeem from the ETF), that individual shares can only be bought and sold on the secondary market through a broker-dealer, and that shareholders may pay more than net asset value ("NAV") when they buy ETF shares and receive less than NAV when they sell shares because shares are bought and sold at current market prices.[165] We also proposed to amend the fee table disclosure in Form N-1A to exclude fees and expenses for purchases or redemptions of creation units and instead to modify the narrative explanation preceding the example in the fee table to state that investors in ETF shares may pay brokerage commissions that are not reflected in the example.[166] Commenters

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163 The amendments we proposed in the ETF Proposing Release incorporated most of the comments from Barclays Global Fund Advisors ("BGFA") in response to the Proposing Release. See Letter of BGFA (Feb. 28, 2008) ("BGFA Letter"). BGFA also requested guidance on how disclosure requirements in future exemptive orders will be integrated into the summary section of the prospectus. We are unable to provide guidance in this release because we do not know what additional disclosure requirements, if any, would be required for ETFs that form and operate pursuant to future exemptive orders. Additional disclosure requirements, if any, will be included in those exemptive orders.

164 Item 6(c)(ii) of Form N-1A.

165 See proposed Item 6(h)(3) and (4) of current Form N-1A; proposed Instruction 3 to Item 6(h) of current Form N-1A.

166 Proposed Instruction 1(e)(i) to current Item 3 of Form N-1A. One commenter to the ETF Proposing Release requested that we require ETFs to include spread costs in the fee table.

who addressed the proposed amendments generally supported this approach.[167] We are adopting the amendments largely as proposed, with minor changes to conform to the final amendments to the summary section.[168] ETFs still will be required to include disclosure on how creation units are offered to the public in the SAI.[169]

Consistent with our proposal, the alternative disclosures in Items 3 and 6 of Form N-1A will not be available to ETFs with creation units of less than 25,000 shares.[170] Although only certain financial institutions purchase and redeem creation units directly from an ETF, individual or retail investors may be more likely to transact in creation units through one of these financial institutions if the creation unit size is less than 25,000

See Letter of BGFA (May 16, 2008) (File No. S7-07-08) ("BGFA Letter on ETF Proposing Release"). This information is required to be disclosed pursuant to rule 11Ac1-5(b) of the Exchange Act [17 CFR 240.11Ac1-5(b)] and is publicly available to investors and the market, which considers the effect of spreads. We did not follow the commenter's suggestion because we believe that disclosure regarding additional spreads in an ETF prospectus, particularly in the summary section, would not be meaningful to most investors and may be confusing.

167 See, e.g., BGFA Letter on ETF Proposing Release, supra note 166, Letter of Investment Company Institute (May 19, 2008) (File No. S7-07-08) ("ICI Letter on ETF Proposing Release").

168 Item 6(c)(i) of Form N-1A; Instruction 1(e)(i) to Item 3 of Form N-1A. Item 6(c)(i)(B) requires disclosure that ETF shares may trade at a price greater than NAV (premium) or less than NAV (discount). The final amendments, like the proposed amendments, also will require each ETF to identify the exchange ticker symbol(s) and principal U.S. market(s) on which the shares are traded. Item 1(a)(2) of Form N-1A; rule 498(b)(1)(ii) 17 CFR 230.498(b)(1)(ii). We also are adopting a conforming amendment to the expense example in ETF annual and semi-annual reports. Instruction 1(e)(i) to Item 27(d) of Form N-1A.

169 Item 23(a) of Form N-1A. Consistent with our proposal, we are not amending this disclosure to include information on creation unit redemption, which Item 11 requires and which we are eliminating for ETFs. See Item 11(g) of Form N-1A.

170 Instruction (1)(e)(ii) to Item 3 of Form N-1A; Item 6(c)(ii) of Form N-1A. We also are adopting a conforming amendment to the expense example in ETF annual and semi-annual reports. Instruction 1(e)(ii) to Item 27(d) of Form N-1A.

shares.[171] Because there is greater potential for retail investors to transact (indirectly) in creation units as they decrease in size, we are requiring any ETF that sells and redeems its shares in creation units of 25,000 or less to include in its prospectus information on how to purchase and redeem creation units and the costs associated with those transactions.[172]

b. Total Return

At the suggestion of commenters, we are not adopting our proposal that ETFs include disclosure of market price returns in addition to returns based on NAV.[173] Like any other fund that files Form N-1A, an ETF must disclose returns based on NAV.[174] All

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[171] ETFs directly sell and redeem creation units only to investors ("authorized participants"), usually brokerage houses, with which the ETF has a contractual agreement. See, e.g., Investment Company Act Release No. 27963 (Aug. 31, 2007) [72 FR 51475 (Sept. 7, 2007)]. The authorized participant may act as a principal in the transaction or as agent for another, typically an institutional investor.

[172] We have not, as one commenter to the ETF Proposing Release suggested, used a dollar value of a creation unit as the threshold for disclosure. See ICI Letter on ETF Proposing Release, supra note 167. We do not want to establish a threshold that may change (and as a consequence require amended disclosure) as a result of fluctuations in portfolio value rather than direct action by the ETF. We also disagree with one commenter who opined that the proposed threshold would create a de facto minimum of 25,000 shares for creation units and suggested that the threshold for exemptions from disclosure be set at 1,000 shares. See Letter of James J. Angel (May 16, 2008) (File No. S7-07-08). Other commenters, including ETF sponsors, explained they supported the proposed exemption from disclosure on the purchase and redemption of creation units because the information would confuse retail investors rather than because the disclosures were particularly costly or burdensome. See BGFA Letter on ETF Proposing Release, supra note 166; ICI Letter on ETF Proposing Release, supra note 167; Letter of Xshares Advisors LLC (May 20, 2008) (File No. S7-07-08) ("Xshares Letter"). Thus, it seems unlikely that an exemption from these disclosures would outweigh the other factors an ETF considers in determining the appropriate size of a creation unit, and we have not reduced the threshold for the exemption. See ICI Letter on ETF Proposing Release, supra note 167 ("[T]he appropriate size of a creation unit may vary depending on a number of factors, such as the type and availability of component securities, the expected uses of the product, and the likely Authorized Participants.").

[173] See ETF Proposing Release, supra note 14, 73 FR at 14623 n. 163 and preceding, accompanying, and following text.

[174] See Item 13(a) of Form N-1A.

commenters who addressed this proposal opposed it.[175] They disagreed that these returns would be more relevant to an investor's experience in the ETF than returns based on NAV because market price (which we proposed to define as closing price) is not tied to an investor's particular purchase price.[176] One commenter suggested that while NAV also does not represent any single investor's experience, it provides a better metric of performance than market price.[177] After consideration of these comments, we agree with these commenters that market price returns would not more closely represent the experience of any particular investor and may confuse investors, particularly when disclosed next to NAV returns.[178] We therefore are not requiring ETFs to disclose market price returns in Form N-1A.[179]

We also are not adopting our proposal that would have required an index-based ETF to compare its performance to its underlying index rather than a benchmark index.[180] Commenters on the ETF proposing release stated that we should not change the disclosure requirement for index-based ETFs without changing the requirement for all

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175 See ICI Letter on ETF Proposing Release, supra note 167; BGFA Letter on ETF Proposing Release, supra note 166; Xshares Letter, supra note 171.

176 See ICI Letter on ETF Proposing Release, supra note 167; Xshares Letter, supra note 172.

177 ICI Letter on ETF Proposing Release, supra note 167 ("[NAV] provides a consistent metric calculated as of the same time each day in accordance with the fund's valuation policies and procedures, and is not subject to the influence of outlier bids or offers.").

178 See id.; BGFA Letter on ETF Proposing Release, supra note 166.

179 Similarly, we are not adopting our proposed conforming amendments to the total return information in ETF annual reports. See ETF Proposing Release, supra note 14, 73 FR at 14633 nn. 171-172 and accompanying text.

180 See ETF Proposing Release, supra note 14, 73 FR 14633 at nn. 173-174.

index funds.[181] We agree that the proposed change should be considered with respect to all index funds, not just index-based ETFs, and therefore, we are not adopting this amendment but may consider future rulemaking.[182]

c. Premium/Discount Information

We are adopting, as proposed, the amendments to the form to require each ETF to disclose to investors information about the extent and frequency with which market prices of fund shares have tracked the fund's NAV.[183] Each ETF will be required to disclose in its prospectus the number of trading days during the most recently completed calendar year and quarters since that year on which the market price of the ETF shares was greater than the fund's NAV and the number of days it was less than the fund's NAV (premium/discount information).[184] This disclosure is designed to alert investors to the

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181 See, e.g., ICI Letter on ETF Proposing Release, supra note 167; Xshares Letter, supra note 171.

182 We also are not, as one commenter suggested, eliminating the required disclosure concerning portfolio turnover information for index-based ETFs. See BGFA Letter, supra note 166. Although most ETFs may sell and redeem their creation units in kind (i.e., for a basket of assets), they still engage in portfolio transactions in order to conform the portfolio to changes in the index. We believe that information regarding portfolio turnover also may be relevant to an investor who is comparing an investment in an index-based ETF to an investment in an open-end index fund.

183 Item 11(g)(2) of Form N-1A. See ETF Proposing Release, supra note 14, 73 FR at 14632 nn. 166-169 and accompanying and following text. ETFs currently are required to disclose on their Internet Web sites the prior business day's last determined NAV, the market closing price of the fund's shares or the midpoint of the bid-ask spread at the time of the calculation of NAV ("bid-ask price"), and the premium/discount of that price to NAV. See, e.g., WisdomTree Investments, Inc. et al., Investment Company Act Release Nos. 27324 (May 18, 2006) [71 FR 29995 (May 24, 2006)] (notice) and 27391 (June 12, 2006) (order); PowerShares Exchange Traded Fund Trust et al., Investment Company Act Release Nos. 25961 (Mar. 4, 2003) [68 FR 11598 (Mar. 11, 2003)] (notice) and 25985 (Mar. 28, 2003) (order).

184 Consistent with our proposal, the final amendments require ETFs to present premiums or discounts as a percentage of NAV. Instruction 2 to Item 11(g)(2) of Form N-1A. See ETF Proposing Release, supra note 14, 73 FR at 14632 nn. 166-169 and accompanying and following text. ETFs also will have to explain that shareholders may pay more than NAV when purchasing shares and receive less than NAV when selling, because shares

relationship between NAV and the market price of the ETF's shares, and that investors may purchase or sell ETF shares at prices that do not correspond to NAV. In addition, this disclosure will provide historical information regarding the frequency of these deviations.

Commenters on the ETF proposing release were divided as to whether this specific premium/discount information would be useful to investors, although all who commented suggested the information need only be provided on the ETF's Web site.[185] Based on these comments, it appears that specific premium/discount information may not be generally useful to all ETF investors. For that reason, an ETF may omit the disclosure of specific premium/discount information in its prospectus or annual report if the fund provides the information on its Internet Web site and discloses in the prospectus or annual report an Internet address where investors can locate the information.[186] Because

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are bought and sold at market prices. Instruction 3 to Item 11(g)(2) of Form N-1A. Consistent with the proposal, the final amendments require ETFs to include a table with premium/discount information in their annual reports for the five recently completed fiscal years. Item 27(b)(7)(iv) of Form N-1A. We are including instructions similar to those in Item 11 to assist funds in meeting this disclosure obligation. Instructions to Item 27(b)(7)(iv) of Form N-1A.

185 See Xshares Letter, supra note 172 ("[W]e believe that the disclosure of [premium/discount] information is useful to investors and support this requirement."); Letter of NYSE Arca (May 28, 2008) (File No. S7-07-08) (asserting generally that disclosure of premium/discount information required on the Web site, together with other available index or portfolio information provides necessary information to investors to assess ETF pricing against the underlying index or portfolio). But see BGFA Letter on ETF Proposing Release, supra note 166 ("[T]he concept of premium/discount may not be an instructive way of thinking about ETF share prices in the secondary market ... BGFA's Internet website experience suggests investors do not value this information highly."); ICI Letter on ETF Proposing Release, supra note 167 (premium/discount information is not particularly useful and investors do not regularly seek it).

186 Item 11(g)(2) of Form N-1A; Item 27(b)(7)(iv) of Form N-1A. Although the time period required in the disclosure is different in the prospectus and annual report, ETFs will be able to omit both disclosures by providing on their Internet Web sites only the premium/discount information required by Item 11(g)(2) (the most recently completed fiscal year and quarters since that year). Id. In order to rely on the exemptive orders that permit them to operate, ETFs also must disclose on their Web sites each day the premium

ETFs may choose to provide this disclosure on their Web sites instead of in their prospectuses, we have added a requirement that the prospectus disclose that ETF shares may trade at a premium or discount.[187] This approach is designed to require disclosure of the information, but avoid duplicative disclosures that may result in additional regulatory burdens. Commenters who addressed the issue strongly supported permitting ETFs to include historical premium/discount information on their Web sites instead of in their prospectuses and annual reports.[188] Our amendments allow ETFs to choose the most cost-effective method of providing this disclosure to their investors.

For purposes of calculating premium/discount information, we are adopting, with a modification, the proposed definition of "market price."[189] Commenters objected to our proposed definition of market price as the closing price because of stale pricing concerns.[190] These commenters suggested that ETFs instead be permitted to use the mid-

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and discount of the market closing price or the bid/ask price against the NAV as a percentage of NAV. See supra note 183. Investors in ETFs that choose not to disclose the required premium/discount information in their prospectuses or annual reports would be able to review historic and daily premium/discount information on the ETF's Web site.

187 Item 6(c)(i)(B) of Form N-1A.

188 See, e.g., BGFA Letter on ETF Proposing Release, supra note 166 ("Duplicative disclosure strikes us as unnecessary and burdensome .... Because data in a prospectus speaks of the prospectus date and therefore does not include the most recent information, we believe Internet Web site disclosure is preferable to prospectus disclosure. Accordingly, we believe that it would be sufficient to reference the availability of the information on the Internet Web site in a prospectus.").

189 General Instruction A of Form N-1A. See ETF Proposing Release, supra note 14, 73 FR at 14632 nn. 164-165 and accompanying text for a discussion of the proposed definition of "market price."

190 See, e.g., Letter of Chapman and Cutler LLP (May 19, 2008) (File No. S7-07-08) ("Chapman Letter"); ICI Letter on ETF Proposing Release, supra note 167 (noting that the closing price may be less accurate because the last trade occurred at a much earlier time than the NAV calculation).

point between the highest bid and the lowest offer at the time the fund's NAV is calculated.[191] To address these concerns, the final amendments define the term "market price" to mean the closing price on the principal market on which ETF shares trade or within the range between the highest offer and the lowest bid if that price more accurately reflects the current market value of the fund's shares at the time the Fund calculates its NAV.[192]

5. Conforming and Technical Amendments to Form N-1A

The foregoing amendments to Form N-1A require adding new items to the form and revising and renumbering certain existing items. We are adopting conforming

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[191] See, e.g., Chapman Letter, supra note 190; ICI Letter on ETF Proposing Release, supra note 167. See also, e.g., Claymore Exchange-Traded Fund Trust, Investment Company Act Release No. 27469 (Aug. 28, 2006) [71 FR 51869 (Aug. 31, 2006)] (exemptive order permitting ETF to operate in which ETF has used the mid-point price, rather than the closing price, in circumstances when closing price may be less accurate because the last trade occurred at a much earlier point in the day than NAV calculation). One commenter also noted that the principal trading market for an ETF may shift during the trading day and, therefore, that the rule should use the market price on the various principal U.S. markets on which the ETF shares trade during a regular trading session. See Chapman Letter, supra note 190. We have not incorporated this suggestion in our amendments. We note that rules of the national securities exchanges use the term "principal market." See, e.g., NYSE Arca Rule 6.1(b)(27) (in its rule that applies to options trading on the exchange, defining "primary market" in respect of an underlying stock or ETF share to mean "the principal market in which the underlying stock or [ETF share] is traded."). We have included the term "trading" to be clear that the term does not refer to the principal listing market. In addition, expanding the rule to various principal trading markets may be confusing and could create the potential that funds will seek the market that provides the best bid/offer.

[192] Definition of "Market Price" in General Instruction A of Form N-1A ("Market Price" refers to the last reported sale price at which ETF shares trade on the principal U.S. market on which the fund's shares are traded during a regular trading session or, if it more accurately reflects the current market value of the fund's shares at the time the fund uses to calculate its NAV, a price within the range of the highest bid and lowest offer on the principal U.S. market on which the fund's shares are traded during a regular trading session."). See Codification of Financial Reporting Policies, Section 404.03.b.ii, "Valuation of Securities—Securities Listed or Traded on a National Securities Exchange," reprinted in SEC Accounting Rules (CCH) ¶ 38,221, at 38.424-25. See also Fair Value Measurements, Statement of Financial Accounting Standards No. 157, § 24 (Fin. Accounting Standards Bd. 2006).

amendments to Form N-1A, consistent with these revisions and renumbering, in order to update the table of contents and the various references to Form N-1A items contained within the form. We are also adopting technical amendments to Form N-1A to update the Commission's telephone number and address.[193]

B. New Delivery Option for Mutual Funds

1. Use of Summary Prospectus and Satisfaction of Statutory Prospectus Delivery Requirements

The Commission is adopting, with modifications to address commenters' concerns, the proposal to replace rule 498[194] with a new rule that permits the obligation under the Securities Act to deliver a statutory prospectus with respect to mutual fund securities to be satisfied by sending or giving a Summary Prospectus and providing the statutory prospectus online. In addition, the new rule will require a fund to send the statutory prospectus in paper or by e-mail upon request. The Summary Prospectus is required to contain the key information that is included in the new summary section of the statutory prospectus in the same order that is required in the statutory prospectus.

The new rule is intended to create a disclosure regime that is tailored to the unique needs of mutual fund investors in a manner that provides ready access to the information that investors need, want, and choose to review in connection with a mutual fund purchase decision. The rule provides for a layered approach to disclosure in which key information is sent or given to the investor and more detailed information is provided

193 Cover page to Form N-1A; Item 1(b)(3) of Form N-1A.

194 As adopted in 1998, rule 498 permits mutual funds to offer investors a disclosure document called a "profile," which summarizes key information about the fund. An investor deciding to purchase fund shares based on the information in a profile is required to receive the fund's statutory prospectus with the security or confirmation of purchase. Investment Company Act Release No. 23065 (Mar. 13, 1998) [63 FR 13968 (Mar. 23, 1998)]. The amendments we are adopting today result in the elimination of the profile.

online and, upon request, is sent in paper or by e-mail. This is intended to provide investors with better ability to choose the amount and type of information to review, as well as the format in which to review it (online or paper). In addition, the provision of a Summary Prospectus containing key information about the fund, coupled with online provision of more detailed information, should aid investors in comparing funds.[195] In short, we believe that the new rule will result in funds providing investors with more useable information than they receive today in a format that investors are more likely to use and understand. Under the new rule, an investor could choose to receive the statutory prospectus in the same paper format that would be provided under our prior rules.

The new rule provides that any obligation under Section 5(b)(2) of the Securities Act[196] to have a statutory prospectus precede or accompany the carrying or delivery of a mutual fund security in an offering registered on Form N-1A is satisfied if (1) a Summary Prospectus is sent or given no later than the time of the carrying or delivery of the fund security;[197] (2) the Summary Prospectus is not bound together with any materials, except

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195 A recent survey indicated that 90% of investors surveyed had access to the Internet. See Telephone Survey Report, supra note 32, at 115. It also indicated over half (56%) rely on the Internet to some extent (ranging from "a little" to "completely") in making investment decisions. Id. at 116. The survey report further indicated that 53% of respondents who own mutual funds accessed investment information via the Internet. Id. at 6.

196 15 U.S.C. 77e(b)(2).

197 A fund could rely upon existing Commission guidance, which typically requires affirmative consent from individual investors, to send or give a Summary Prospectus by electronic means. See Securities Act Release No. 7233 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)]; Securities Act Release No. 7856 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)]. If, prior to the effective date of this rule, an investor had consented in accordance with existing Commission guidance to receive future versions of one or more funds' statutory prospectuses by electronic means, we would not object if a fund or financial intermediary relies on that consent to send or give the Summary Prospectuses of those funds by electronic means to that investor, provided that the consent is not otherwise revoked.

as described below; (3) the Summary Prospectus that is sent or given satisfies the rule's requirements at the time of the carrying or delivery of the fund security; and (4) the conditions set forth in the rule, which require a fund to provide the Summary Prospectus, statutory prospectus, and other information on the Internet in the manner specified in the rule, are satisfied.[198] As discussed in more detail below, we have changed the proposed condition that the Summary Prospectus be given "greater prominence" than accompanying materials into a requirement of the rule, rather than a condition to satisfaction of delivery obligations under Section 5(b)(2) of the Securities Act. We have also clarified that any particular Summary Prospectus is not required to be given "greater prominence" than any other Summary Prospectuses or statutory prospectuses. As adopted, we are also permitting the Summary Prospectuses and statutory prospectuses of multiple underlying funds of a variable insurance contract to be bound with each other and with the statutory prospectus for the contract.

Section 5(b)(2) of the Securities Act makes it unlawful to deliver a security for purposes of sale or for delivery after sale "unless accompanied or preceded" by a statutory prospectus. Under the rule, delivery of the statutory prospectus for purposes of Section 5(b)(2) is accomplished by sending or giving a Summary Prospectus and by providing the statutory prospectus and other required information online. Failure to comply with the rule's requirements for sending or giving a Summary Prospectus and providing the statutory prospectus and other information online would mean that the rule could not be relied on to meet the Section 5(b)(2) prospectus delivery obligation. Absent

198 Rule 498(c).

satisfaction of the Section 5(b)(2) obligation by other available means,[199] a Section 5(b)(2) violation would result. The rule also requires a fund to send the statutory prospectus upon request. This requirement is not a condition to reliance on the rule, and failure to send the requested statutory prospectus will result in a violation of the rule (as opposed to a violation of Section 5(b)(2)).

Section 5(b)(2) does not require delivery of the statutory prospectus prior to delivery of the security or confirmation of the transaction. As a result, mutual fund investors too often receive the statutory prospectus after the purchase transaction when the investment decision is complete. The rules we are adopting will, in practice, require any fund that is relying on the Summary Prospectus to meet its obligations under Section 5(b)(2) to post both its Summary Prospectus and statutory prospectus on the Internet at all times. This will result in significantly enhanced access by investors to information about the fund prior to the time of making an investment decision. Several commenters observed that it would be helpful if investors could review a Summary Prospectus prior to making an investment decision.[200] We intend to consider additional steps in the future that would further enhance investors' access to the Summary Prospectus, other

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199 These include paper delivery of a statutory prospectus or electronic delivery of a statutory prospectus in reliance upon existing Commission guidance. See supra note 197 for existing Commission guidance on electronic delivery. We note that it would be permissible to satisfy Section 5(b)(2) obligations by relying on rule 498 to send or give a Summary Prospectus to some investors, while providing a statutory prospectus to others. For example, it would be permissible to rely on rule 498 to send or give the Summary Prospectus to existing investors who purchase additional shares while providing the statutory prospectus to new investors. It would also be permissible for a life insurance company to satisfy Section 5(b)(2) obligations with respect to a variable insurance contract by relying on rule 498 to send or give a Summary Prospectus with respect to some underlying funds, while providing a statutory prospectus with respect to other underlying funds, for example, where some underlying funds maintain a Summary Prospectus while others do not.

200 See, e.g., AARP Letter, supra note 34; Fund Democracy et al. Letter, supra note 34.

information about the fund, and enhanced information about broker and intermediary compensation and conflicts of interest before the investment decision. For example, we continue to consider appropriate disclosures at the point of sale by financial intermediaries, including whether there should be an obligation to direct investors to the online availability of the Summary Prospectus and offer investors a copy of the Summary Prospectus.[201]

The rule we are adopting also provides that a communication relating to an offering registered on Form N-1A that is sent or given after the effective date of a mutual fund's registration statement (other than a prospectus permitted or required under Section 10 of the Securities Act) shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act if (1) it is proved that prior to or at the same time with the communication a Summary Prospectus was sent or given to the person to whom the communication was made; (2) the Summary Prospectus is not bound together with any materials, except as described below; (3) the Summary Prospectus that was sent or given satisfies the rule's requirements at the time of the communication; and (4) the conditions set forth in the rule, which require a fund to provide the Summary Prospectus, statutory prospectus, and other information on the Internet in the manner specified in the rule, are satisfied.[202] This provision is similar to Section 2(a)(10)(a) of the Securities Act, which provides that a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of Section 10) shall not be deemed a

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201 See supra note 155. To the extent that we conclude that such an obligation on the part of financial intermediaries is appropriate, we would also consider similar obligations in the case of funds that are sold directly to investors.

202 Rule 498(d). This provision is limited to a mutual fund Summary Prospectus that satisfies the terms of the proposed rule and does not apply in the case of any issuer other than a mutual fund.

prospectus if it is proved that prior to or at the same time with the communication a written prospectus meeting the requirements for a statutory prospectus at the time of the communication was sent or given to the person to whom the communication was made.[203] Pursuant to this provision, communications that would otherwise be considered "prospectuses" subject to the liability provisions of Section 12(a)(2) of the Securities Act are not deemed prospectuses and are not subject to Section 12(a)(2) if they are preceded or accompanied by the statutory prospectus.[204] Similarly, under the new rule, communications that are preceded or accompanied by a Summary Prospectus are not deemed to be prospectuses and are not subject to Section 12(a)(2) if all the conditions of the rule are met. These communications remain subject to the general antifraud provisions of the federal securities laws.[205]

Commenters generally supported the proposal, noting that investors will be more likely to read and understand the Summary Prospectus than the statutory prospectus and that use of the Summary Prospectus will help investors to focus on what is most important in making investment decisions with respect to a particular fund.[206] One commenter noted that its own research has shown that most investors do not find the statutory prospectus to be a particularly useful document and do not rely heavily on it in

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203 15 U.S.C. 77b(a)(10)(a).

204 15 U.S.C. 77l(a)(2). Section 12(a)(2) of the Securities Act imposes liability for materially false or misleading statements in a prospectus or oral communication, subject to a reasonable care defense.

205 See, e.g., Section 17(a) of the Securities Act [15 U.S.C. 77q(a)]; Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)]; Section 34(b) of the Investment Company Act [15 U.S.C. 80a-33(b)].

206 See, e.g., AARP Letter, supra note 34; CMFI Letter, supra note 44; Fund Democracy et al. Letter, supra note 34; ICI Letter, supra note 34; MFDF Letter, supra note 34.

making a fund selection. The commenter agreed that it makes little sense to continue to require delivery of a document to all investors that most say they do not value.[207] A second commenter noted that the proposal "reflects the strikingly broad consensus that investors would be best served by simplified, streamlined disclosure of essential fund information" and is supported by research conducted by the Commission and others.[208] Similarly, investors in our focus groups generally expressed favorable views of the Summary Prospectus, noting its usefulness as a screening tool to identify funds that they might wish to research further.[209] Commenters also approved of the proposal's use of the power of the Internet and advances in technology to deliver information to investors.[210]

Two commenters argued that use of the Summary Prospectus should be mandatory, including one who noted that inconsistent use of the Summary Prospectus could create confusion and would make comparison of funds more difficult for investors.[211] We have determined not to mandate use of the Summary Prospectus at this time. We believe that further public comment on this important step is necessary, and we intend to review the use of the Summary Prospectus by investors in funds that voluntarily

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207 See Fund Democracy et al. Letter, supra note 34.

208 See ICI Letter, supra note 34.

209 Focus Group Report, supra note 32, at 5-6 (quoting participants as stating "I think it cuts to the important factors of performance, cost, objectives. I like it;" "It's a two-minute read. If I want more information, I can ask for it;" "I think that this [short-form prospectus] you'd read and if you're interested and then you've got questions and you want to go more in-depth and go to the long one;" "I think both [the long and short-form prospectuses] have their place. I think it would be foolish to give up the long-form for (the short[-]form) and I think it would be foolish not to have the short-form and insist on a long-form. They both have their place.").

210 See, e.g., AARP Letter, supra note 34; CMFI Letter, supra note 44; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44.

211 See Letter of Kevin Possin and Ann Lavine (Feb. 7, 2008); Vanguard Letter, supra note 42.

adopt the Summary Prospectus and reconsider whether the Summary Prospectus should be mandated in the future.

As noted above, we are modifying the rule's conditions in three respects to address the concerns of commenters. First, we have eliminated the condition that the Summary Prospectus be given greater prominence than any accompanying materials[212] and instead made it a rule requirement.[213] Second, we have modified this requirement to clarify that a Summary Prospectus need not be given "greater prominence" than other Summary Prospectuses or statutory prospectuses that accompany the Summary Prospectus. Third, we have revised the condition that would have prohibited the Summary Prospectus from being bound together with any other materials[214] to permit a Summary Prospectus for a fund that is available as an investment option in a variable annuity or variable life insurance contract to be bound together with the statutory prospectus for the contract and Summary Prospectuses and statutory prospectuses for other investment options available under the contract.[215]

We have made the "greater prominence" standard a rule requirement instead of a condition to satisfaction of Section 5(b)(2) obligations.[216] While we continue to believe that the "greater prominence" requirement is important to prevent the Summary Prospectus from being obscured by accompanying sales and other materials and to

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212 Proposed rule 498(c)(1) and (d)(1).

213 Rule 498(f)(2).

214 Proposed rule 498(c)(1) and (d)(1).

215 Rule 498(c)(2) and (d)(2).

216 Rule 498(f)(2).

highlight for investors the concise, balanced presentation of the Summary Prospectus,[217] we are persuaded by commenters that the consequences of failure to meet the condition – a Section 5 violation – is not needed to achieve our goal.[218] Therefore, we are adopting commenters' suggestion that satisfaction of the "greater prominence" standard be a rule requirement.[219] As adopted, the "greater prominence" requirement is not a condition to reliance on the rule to satisfy a fund's or intermediary's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with the conditions to the rule will not violate Section 5(b)(2) if the "greater prominence" standard is not satisfied. This failure will, however, constitute a violation of the Commission's rules. Generally, we believe that the "greater prominence" requirement would be satisfied if the placement of the Summary Prospectus is more prominent than accompanying materials, e.g., the Summary Prospectus is on top of a group of paper documents that are provided together.[220]

We are adopting the condition that prohibits a Summary Prospectus from being bound together with any other materials. Although commenters were split on the proposed binding prohibition, with some supporting the requirement and others opposed

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217 See, e.g., Pace Letter, supra note 125 (expressing support for the "greater prominence" requirement).

218 See, e.g., ABA Letter, supra note 37; ICI Letter, supra note 34; NYC Bar Letter, supra note 75.

219 See, e.g., ABA Letter, supra note 37; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44.

220 In response to a commenter's concerns, we are making a technical change to the "greater prominence" requirement to clarify that any particular Summary Prospectus need not be given "greater prominence" than any other Summary Prospectuses or statutory prospectuses that accompany the Summary Prospectus. See ICI Letter, supra note 34.

or seeking modifications,[221] we continue to believe that it is important to prevent the Summary Prospectus from being obscured by accompanying sales and other materials and to highlight for investors the concise, balanced presentation of the Summary Prospectus. We are, however, persuaded that it is appropriate to permit binding the statutory prospectus of a variable insurance contract with the Summary Prospectuses and statutory prospectuses of its underlying funds.[222] This will permit satisfaction of prospectus delivery requirements for both a variable insurance contract and its underlying funds in one consolidated package and does not involve any risk of the prospectuses being obscured by sales or other materials. Specifically, under rule 498, a Summary Prospectus for a fund that is available as an investment option in a variable annuity or variable life insurance contract may be bound together with the statutory prospectus for the contract and Summary Prospectuses and statutory prospectuses for other investment options available in the contract, provided that: (i) all of the funds to which the Summary Prospectuses and statutory prospectuses that are bound together relate are available to the person to whom such documents are sent or given; and (ii) a table of contents identifying each Summary Prospectus and statutory prospectus that is bound together, and the page

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221 See, e.g., Pace Letter, supra note 125 (supporting binding prohibition); T. Rowe Letter, supra note 49 (supporting a binding prohibition instead of a "greater prominence" requirement); ICI Letter, supra note 34 (arguing that rule should prohibit Summary Prospectuses from being bound together with sales materials, or alternatively that there be certain specific carve-outs to permit binding of funds' privacy notices and to permit the binding together of Summary Prospectuses for certain similar types of funds); Letter of Charles Schwab & Co., Inc., and Charles Schwab Investment Management, Inc. (Feb. 28, 2008) ("Schwab Letter") (requesting carve-out to permit binding of funds' privacy policies); Data Communiqué Letter, supra note 35 (opposing binding prohibition); Dechert Letter, supra note 50 (opposing binding prohibition); Schnase Letter, supra note 35 (opposing binding prohibition).

222 See, e.g., CAI Letter, supra note 67; Dechert Letter, supra note 50; EQ/AXA Letter, supra note 67; Fidelity Letter, supra note 86; ICI Letter, supra note 34; Vanguard Letter, supra note 42.

number on which it is found, is included at the beginning or immediately following a cover page of the bound materials. These conditions are intended to ensure that investors are not inundated with prospectuses that are not relevant to the contract they are considering and to ensure that investors can readily locate the particular prospectuses in which they are interested.

2. Content of Summary Prospectus

Rule 498 sets forth the content requirements that a Summary Prospectus must satisfy.[223] A Summary Prospectus meeting the requirements of the rule will be deemed to be a prospectus that is authorized under Section 10(b) of the Securities Act and Section 24(g) of the Investment Company Act for the purposes of Section 5(b)(1) of the Securities Act.[224] A Summary Prospectus meeting these content requirements could be used to offer securities of the fund pursuant to Section 5(b)(1) even if the other conditions of the rule were not satisfied. The failure to satisfy these other conditions will, however, preclude the use of the Summary Prospectus for the other purposes described in rule 498, including for purposes of satisfying, in part, a fund's obligation under Section 5(b)(2) to deliver a statutory prospectus. In these circumstances, the Section 5(b)(2) obligation to deliver a fund's statutory prospectus will have to be met by means other than the new rule or a Section 5(b)(2) violation will result.

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223 Rule 498(b). Rule 498(a) defines terms used in the rule.

224 Rule 498(b). Section 10(b) of the Securities Act [15 U.S.C. 77j(b)] authorizes the Commission to adopt rules permitting the use of a prospectus for the purposes of Section 5(b)(1) [15 U.S.C. 77e(b)(1)] that summarizes information contained in the statutory prospectus. Section 24(g) of the Investment Company Act [15 U.S.C. 80a-24(g)] authorizes the Commission to permit the use of a prospectus under Section 10(b) of the Securities Act to include information the substance of which is not included in the statutory prospectus.

a. General

We are adopting, with one clarification, the requirement that the Summary Prospectus include the same information as required in the summary section of the statutory prospectus in the same order required in the statutory prospectus.[225] This key information about investment objectives, costs, and risks forms the body of the Summary Prospectus.

We are adopting a new requirement to clarify that if a fund relies on rule 498 to meet its statutory prospectus delivery obligations, the information contained in the Summary Prospectus must be the same as the information contained in the summary section of the fund's statutory prospectus, except as expressly permitted by rule 498.[226] That is, a fund may not provide different, such as more or less expansive, information in its Summary Prospectus than it provides in its statutory prospectus. If, pursuant to rule 497, a mutual fund files a "sticker" to its statutory prospectus that changes any information in the summary section, the Summary Prospectus should either be "stickered" or amended to reflect the information in the statutory prospectus "sticker." This new requirement is intended to clarify our intent in adopting the same content requirements for the Summary Prospectus and the summary section of the statutory prospectus.

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225 Rule 498(b)(2) (Summary Prospectus to include information required or permitted by Items 2 through 8 of Form N-1A). We are adopting, as proposed, the provision that permits a fund to omit from the Summary Prospectus an explanation of the reasons for any change in the securities market index used for comparison purposes in the performance presentation. Rule 498(b)(2). Cf. Instruction 2(c) to Item 4(b)(2) of Form N-1A (requiring this explanation in summary section of statutory prospectus).

226 Rule 498(f)(4). Rule 498(b)(2) expressly permits a Summary Prospectus to omit certain information relating to a change in the securities market index used for comparison purposes. See supra note 225.

The Summary Prospectus will not be permitted to omit any of the required information or to include additional information except as described below. A document that omits information required in a Summary Prospectus or includes additional information not permitted by the rule will not be a Summary Prospectus under the rule and may not be used under the rule for any purpose, including meeting the obligation to deliver a fund's statutory prospectus.[227] We are adopting these requirements, as proposed, because we believe that uniformity of content in Summary Prospectuses will provide better comparability, which will help investors to make a more informed investment decision, a conclusion which was supported by a number of commenters.[228] While some commenters argued that the rule should provide funds with flexibility to customize the content of the Summary Prospectus,[229] we are not persuaded because customization would significantly impair investors' ability to compare information across funds. We note that, provided the content and order requirements of the rule are met,

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227 A Summary Prospectus that omits certain information required by the rule or includes additional information not permitted by the rule could be deemed to be a prospectus under Section 10(b) of the Securities Act for purposes of Section 5(b)(1) of the Securities Act pursuant to rule 482 under the Securities Act [17 CFR 230.482] if the conditions of that rule are met.

228 See, e.g., Letter of Brown & Associates LLC and Self Audit, Inc. (Feb. 27, 2008) ("Self Audit Letter"); CMFI Letter, supra note 44; Data Communiqué Letter, supra note 35; Evergreen Letter, supra note 41; Firehouse Letter, supra note 35; Great-West Letter, supra note 42; ICI Letter, supra note 34; Keil Letter, supra note 62; Letter of NewRiver, Inc. (Feb. 28, 2008) ("NewRiver Letter"); Oppenheimer Letter, supra note 44; Pace Letter, supra note 125; Schnase Letter, supra note 35.

229 See, e.g., Clarke Letter, supra note 35; Hastie Letter, supra note 59; Letter of Stephen A. Keen (Feb. 28, 2008); Ogg Letter, supra note 75.

funds have almost complete flexibility with respect to design issues, including layout, graphics, and color.[230]

We are adopting, as proposed, the requirement that a Summary Prospectus describe only one fund, but may describe multiple classes of a single fund.[231] This requirement is similar to the requirements for the summary section of the statutory prospectus.[232] Like those requirements, it is intended to result in a presentation of key fund information that is concise and easy to read.

One commenter suggested that the Commission permit funds to satisfy their obligation to deliver a statutory prospectus to their existing shareholders by delivering a document directing shareholders' attention to material changes that have occurred during the covered period.[233] The commenter argued that such an approach would focus

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230 See, e.g., AARP Letter, supra note 34 (Commission "should set broad parameters for compliance with the required substance, format and presentation of the summary prospectus, but also allow funds to use their creativity in designing a form that is truly investor friendly."); Data Communiqué Letter, supra note 35 (favoring similar content, but stating that the Commission should allow for layout and graphical differences).

Summary Prospectuses are subject to the font size and legibility requirements for prospectuses that are set forth in rule 420 under the Securities Act [17 CFR 230.420]. Rule 420 generally requires, among other things, that printed prospectuses be in roman type at least as large and as legible as 10-point modern type.

231 Rule 498(b)(4).

232 See discussion supra introductory text to Part III.A. and "Organizational Requirements" in Part III.A.1.

233 See Fund Democracy et al. Letter, supra note 34. Section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)] generally requires that when a prospectus is used more than nine months after the effective date of the registration statement, the information in the prospectus must be as of a date not more than sixteen months prior to such use. The effect of this provision is to require mutual funds to update their statutory prospectuses annually to reflect current cost, performance, and other financial information. Many funds deliver updated statutory prospectuses annually to their existing shareholders in order to meet their prospectus delivery obligations with respect to additional purchases by those shareholders.

shareholders' attention on the factors that are most likely to affect their continuing evaluation of the fund and impose lower costs than delivery of the Summary Prospectus. We are not adopting this suggestion at this time. We are concerned that creation of an additional document to be used only for existing shareholders could impose significant costs on funds and their shareholders. Moreover, as noted earlier, we recently proposed to require mutual funds to submit in interactive data format information contained in the risk/return summary section of their statutory prospectuses.[234] We are continuing to consider that proposal and believe that, if adopted, this requirement would help investors, intermediaries, and others to readily identify any changes in this information.

b. Cover Page or Beginning of Summary Prospectus

We are adopting, as proposed, the requirements for the cover page or beginning of the Summary Prospectus, with the addition of a requirement to include the exchange ticker symbols of the fund's securities.[235] The Summary Prospectus will be required to include the following information on the cover page or at the beginning of the Summary Prospectus:

- the fund's name and the share classes to which the Summary Prospectus relates;
- the exchange ticker symbol of the fund's securities or, if the Summary Prospectus relates to one or more classes of the fund's securities, adjacent to each such class, the exchange ticker symbol of such class of the fund's securities;
- a statement identifying the document as a "Summary Prospectus"; and

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234 Investment Company Act Release No. 28298, supra note 28, 73 FR at 35443.

235 This requirement is discussed in Part III.A.2.

- the approximate date of the Summary Prospectus's first use.

In addition, the cover page or beginning of the Summary Prospectus is required to include the following legend:

> "Before you invest, you may want to review the Fund's prospectus, which contains more information about the Fund and its risks. You can find the Fund's prospectus and other information about the Fund online at [__________]. You can also get this information at no cost by calling [_____________] or by sending an e-mail request to [__________]."[236]

In addition, the legend may include a statement to the effect that the Summary Prospectus is intended for use in connection with a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code, a tax-deferred arrangement under Section 403(b) or 457 of the Internal Revenue Code, or a variable contract as defined in Section 817(d) of the Internal Revenue Code and is not intended for use by other investors.[237]

The legend is required to provide an Internet address, toll free (or collect) telephone number, and e-mail address that investors can use to obtain the statutory prospectus and other information.[238] The legend is also permitted to indicate that the statutory prospectus and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the fund may be purchased or sold.[239] The Internet address at which the statutory prospectus and other information are available is not permitted to be the address of the Commission's Electronic Data

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236 Rule 498(b)(1).

237 Rule 498(b)(1)(v)(B).

238 Rule 498(b)(1)(v)(A).

239 The Web site and other contact information provided may be the Web site and contact information of a financial intermediary.

Gathering, Analysis, and Retrieval System ("EDGAR").[240] The address is required to be specific enough to lead investors directly to the statutory prospectus and other required information, rather than to the home page or other section of the Web site on which the materials are posted.[241] The Web site could be a central site with prominent links to each required document.[242]

We are not modifying the proposal in response to commenters who suggested that the legend provide more guidance regarding the types of information available,[243] because we believe that investors will be less likely to read a longer legend describing multiple documents and that the legend, as adopted, is sufficient to alert investors to the existence and location of additional information about the fund. Moreover, as discussed below in Part III.B.4.a., a Summary Prospectus that incorporates information by reference is required to include more specific disclosure identifying the documents from which the

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240 Cf. rule 14a-16(b)(3) under the Exchange Act [17 CFR 240.14a-16(b)(3)] (similar requirement in rules relating to Internet availability of proxy materials).

241 For a description of the information required to be available at the Web site and a discussion of the manner in which such information must be available, see the discussion in Part III.B.3. below.

242 One commenter suggested removing the word "prominent" from the phrase "a central site with prominent links" because it calls into question whether a fund complex could have one Web page with numerous links or a drop-down menu allowing users to navigate to disclosure documents for each of the funds. See ICI Letter, supra note 34. We have decided to retain the prominence requirement because we believe that it is important to effective delivery that investors be able to easily find the links to the particular documents in which they are interested. Cf. Exchange Act Release No. 55146 (Jan. 22, 2007) [72 FR 4148, 4153-54 n. 79 (Jan. 29, 2007)] (use of central site with prominent links in electronic delivery of proxy materials). We note, however, that there is no requirement that the links be more prominent than other information. In addition, the requirement for prominent links to the relevant documents could be satisfied by a central site that lists each fund in alphabetical order with, in table format, links to each fund's Summary Prospectus, statutory prospectus, SAI, and annual and semi-annual shareholder report or similar means, such as a drop-down menu allowing users to easily navigate the documents for each of the funds.

243 See, e.g., CMFI Letter, supra note 44; Foreside Letter, supra note 74; MFS Letter, supra note 150.

information is incorporated. We also are not modifying the proposal in response to a commenter who suggested that the legend make clearer that the Summary Prospectus is only a part of the full statutory prospectus.[244] We believe that the combination of the legend and the requirement to identify the Summary Prospectus as a "Summary Prospectus" will provide clear notice to investors that more information is contained in the statutory prospectus.

c. Updating Requirements

We are not adopting the proposed requirement that performance information in the Summary Prospectus be updated quarterly and related provisions of the proposed rule.[245] We are persuaded by commenters who expressed concerns about potential investor confusion, focus on short-term performance, and the costs and operational difficulties associated with implementing quarterly updating.[246] As adopted, the rule will

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[244] See, e.g., Schnase Letter, supra note 35 (state that investors may want to review the fund's "full prospectus" or "complete prospectus" to adequately distinguish it from the Summary Prospectus).

[245] Proposed rule 498(b)(2)(ii) (quarterly updating requirement); proposed rule 498(e) (provisions related to quarterly updating requirement). The proposal also would have required quarterly updating of a fund's top 10 portfolio holdings. Proposed rule 498(b)(2)(iii). As discussed above, we have determined not to require inclusion of a fund's top 10 portfolio holdings in the summary section of the statutory prospectus or in the Summary Prospectus. See discussion supra Part III.A.3.a.

[246] See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; CAI Letter, supra note 67; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Dechert Letter, supra note 50; EQ/AXA Letter, supra note 67; Evergreen Letter, supra note 41; Fidelity Letter, supra note 86; Financial Services Institute Letter, supra note 41; Letter of Financial Services Roundtable (Feb. 28, 2008) ("Financial Services Roundtable Letter"); Firehouse Letter, supra note 35; Letter of Fluent Technologies (Mar. 14, 2008) ("Fluent Letter"); Foreside Letter, supra note 74; Great-West Letter, supra note 42; ICI Letter, supra note 34; IDC Letter, supra note 61; MFS Letter, supra note 150; NYC Bar Letter, supra note 75; Oppenheimer Letter, supra note 44; Putnam Letter, supra note 48; Letter of RiverSource Funds (Feb. 25, 2008) ("RiverSource Letter"); Russell Letter, supra note 48; Schwab Letter, supra note 221; SIFMA Letter, supra note 97; Letter of Stradley Ronon Stevens & Young, LLP (Feb. 28, 2008) ("Stradley Letter"); T. Rowe Letter, supra note 49; USAA Letter, supra note 153; Vanguard Letter, supra note 42.

require a fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number to include a statement explaining this and providing the Web site address and/or telephone number.[247]

Some commenters noted that investors may be confused if different information is contained in the summary section of the statutory prospectus (which the proposal did not require to be updated on a quarterly basis) and the Summary Prospectus.[248] A number of commenters also expressed concern that the proposed quarterly updating requirement signals a troubling shift toward focusing on short-term performance information, rather than encouraging investors to consider long-term performance.[249] Commenters also noted that updated performance information is already widely available on the Internet and from other sources.[250] Many commenters suggested as an alternative that the Commission require annual updating of the Summary Prospectus, with prominent disclosure in the document describing how investors can access updated performance information (i.e., through a Web site address or toll-free telephone number).[251] Investors

247 Item 4(b)(2)(i) of Form N-1A. This requirement is discussed more fully in Part III.A.3.e.

248 See, e.g., Capital Research Letter, supra note 34; Dechert Letter, supra note 50; ICI Letter, supra note 34; NYC Bar Letter, supra note 75; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48; SIFMA Letter, supra note 97; Stradley Letter, supra note 246; T. Rowe Letter, supra note 49.

249 See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Capital Research Letter, supra note 34; Dechert Letter, supra note 50; Fluent Letter, supra note 246; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48.

250 See, e.g., ICI Letter, supra note 34, Vanguard Letter, supra note 42.

251 See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Fidelity Letter, supra note 86; Financial Services Institute Letter, supra note 41; Firehouse Letter, supra note 35; Financial Services Roundtable Letter, supra note 246; IDC Letter, supra note 61; Janus Letter, supra note 63; MFS Letter, supra note 150; Oppenheimer Letter, supra note 44;

participating in our focus groups also indicated that they would be willing to obtain updated fund information online.[252]

In addition, many commenters from the fund industry also stated that the costs and operational difficulties associated with implementing the quarterly updating requirement would discourage funds from using the Summary Prospectus.[253] The commenters noted that updating of Summary Prospectuses would likely require an entirely new process that would be more complex than the one used for existing quarterly fund fact sheets. Moreover, these commenters noted that a quarterly updating requirement would essentially require them to move to an "on demand" printing model for distribution of Summary Prospectuses, which would entail changes in business practices, new or amended vendor contracts, and, for a few fund families, significant initial outlays that could substantially delay implementation of the Summary

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Putnam Letter, supra note 48; Russell Letter, supra note 48; Schwab Letter, supra note 221; T. Rowe Letter, supra note 49.

252 See Focus Group Report, supra note 32, at 11; Focus Group Transcripts, supra note 32, at 25-26; id. at 49 ("I get my information from the Web anyway. So, what the prospectus says is less important in terms of recent performance. Because there's no way that they can tell me what's been going on that recently."); id. at 78 ("You can go to the library and be on the Web and it doesn't cost you anything, except 15 minutes."); id. ("And if it says, 'This is not necessarily the latest, current, go to this Web site and you'll get the full comparison,' that would be acceptable . . . .").

253 See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Dechert Letter, supra note 50; EQ/AXA Letter, supra note 67; Evergreen Letter, supra note 41; Financial Services Roundtable Letter, supra note 246; Fluent Letter, supra note 246; Great-West Letter, supra note 42; ICI Letter, supra note 34; IDC Letter, supra note 61; MFS Letter, supra note 150; Oppenheimer Letter, supra note 44; RiverSource Letter, supra note 246; Russell Letter, supra note 48; Letter of Saturna Capital Corporation (Jan. 14, 2008); Schwab Letter, supra note 221; T. Rowe Letter, supra note 49. The Investment Company Institute, a national association of United States investment companies, conducted a survey of its member firms and noted that up to 70 percent of funds would face substantial cost and operational burdens in complying with a quarterly updating requirement and that these burdens would likely lead funds to elect not to use the Summary Prospectus. ICI Letter, supra note 34.

Prospectus.[254] Financial intermediaries similarly expressed concern about "the ability of even large intermediaries to maintain and track a hard copy inventory of prospectuses which change multiple times per year."[255] Some commenters also noted that updated performance information is already widely available from other sources.[256]

On the other hand, a small number of commenters supported the proposed quarterly updating requirement.[257] One such commenter argued that quarterly updating would enhance the public's perception of the Summary Prospectus and the information provided. The commenter noted that funds presently provide such updated information in their sales materials; that displaying annually updated performance information in the statutory prospectus and quarterly updated information in the Summary Prospectus would not necessarily confuse investors; and that although funds post updated information online throughout the year, investors without access to the Internet would be greatly disadvantaged if the Commission did not require quarterly updating of the paper Summary Prospectus.[258]

We have determined not to require quarterly updating of performance information in the Summary Prospectus because we are persuaded that this requirement could confuse investors and would discourage funds from using the Summary Prospectus and thereby undermine our goal of encouraging concise, user-friendly disclosure to investors. We

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[254] See, e.g., ICI Letter, supra note 34.

[255] See, e.g., SIFMA Letter, supra note 97.

[256] See, e.g., ICI Letter, supra note 34, Vanguard Letter, supra note 42.

[257] See, e.g., CMFI Letter, supra note 44; Data Communiqué Letter, supra note 35; Keil Letter, supra note 62; NAPFA Letter, supra note 44.

[258] See Data Communiqué Letter, supra note 35.

have concluded that the benefits to be derived from quarterly updating do not outweigh this significant disincentive to use of the Summary Prospectus because updated performance information is widely available in fund sales materials, on fund Web sites, and from third-party sources. As noted above, investors in our focus groups indicated that they would be willing to obtain updated information online. As a result, we are requiring a fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number to include a statement explaining this and providing the Web site address and/or telephone number.[259] This approach will eliminate any potential investor confusion that could arise as a result of a fund's Summary Prospectus containing more updated information than the fund's statutory prospectus.

3. Provision of Statutory Prospectus, SAI, and Shareholder Reports

We are adopting, with certain modifications to address the concerns of commenters, the requirement that, in addition to sending or giving a Summary Prospectus, a person relying on rule 498 to meet its statutory prospectus delivery obligations must provide the statutory prospectus on the Internet, together with other information, in the manner specified by the rule.[260] We are also adopting, as proposed, the requirement to send the statutory prospectus to any investor requesting a copy. We believe that requiring the statutory prospectus to be provided in two ways, by posting on an Internet Web site and by sending the information directly to any investor requesting a copy, maximizes both the accessibility and usability of the information, as indicated by the preference of commenters and investors participating in our focus groups for access

[259] Item 4(b)(2)(i) of Form N-1A. This requirement is discussed more fully in Part III.A.3.e.

[260] Rule 498(c)(4), (d)(4), and (e).

to both online and paper resources.[261] Sending the information directly to an investor is not, however, a condition of reliance on the rule.

a. Documents Required to be Provided on the Internet

Under the rule, the statutory prospectus and other information are required to be provided through the Internet as follows. The fund's current Summary Prospectus, statutory prospectus, SAI, and most recent annual and semi-annual reports to shareholders are required to be accessible, free of charge, at the Web site address specified on the cover page or at the beginning of the Summary Prospectus.[262] These documents are required to be accessible on or before the time that the Summary Prospectus is sent or given and current versions of the documents are required to remain on the Web site through the date that is at least 90 days after (i) in the case of reliance on the rule to satisfy the obligation to have a statutory prospectus precede or accompany the carrying or delivery of a mutual fund security, the date that the mutual fund security is carried or delivered, or (ii) in the case of reliance on the rule to deem a communication with respect to a mutual fund security not to be a prospectus under Section 2(a)(10) of the Securities Act, the date that the communication is sent or given.[263] This requirement is

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261 See AARP Letter, supra note 34 (supporting the proposal and noting that "timely access to hard copy, print disclosure must remain an option that is easy to exercise for investors choosing to do so"); Miller Letter, supra note 110 ("ensure a simple process for obtaining mutual fund information in paper format in order to maximize accessibility"); Focus Group Report, supra note 32, at 12 (noting that some participants preferred to read lengthy documents on the computer screen, while others indicated that they prefer paper documents); Focus Group Transcripts, supra note 32, at 28 ("not everybody has [a] computer, so there has to be alternatives"); id. at 50 and 78 (quoting most investors as preferring to receive fund information online but also quoting some investors who prefer to obtain at least some fund information on paper).

262 The cost to access the Internet itself (e.g., monthly subscription to an Internet service provider) and related costs, such as the cost of printer ink, are not considered costs for purposes of determining whether information is accessible, free of charge.

263 Rule 498(e)(1).

designed to ensure continuous access to the information from the time the Summary Prospectus is sent or given until at least 90 days after the date of delivery of a security or communication in reliance on rule 498.

A number of commenters expressed concern regarding the meaning of the term "current" and asked whether funds would be required to maintain stale information online.[264] In response to these commenters' concerns, we note that the "current" standard does not require a fund to maintain online an outdated version of a document that was current at the time the Summary Prospectus was sent or given, but that has subsequently been updated. Rather, the "current" standard requires a fund to maintain updated versions of the required documents online.

Several commenters argued that a person relying on the rule should not be required to provide the fund's SAI on the Web site.[265] We have not adopted this suggestion. As discussed above, the rule provides for a layered approach to disclosure in which key information is sent or given to the investor and more detailed information is provided online and, upon request, is sent in paper or by e-mail. The approach of rule 498 is two-fold, both to encourage funds to provide a concise, user-friendly Summary Prospectus to investors and to enhance investor access to more detailed information. Requiring the SAI to be provided online furthers the latter goal.[266]

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264 See, e.g., AIM Letter, supra note 47; ICI Letter, supra note 34.

265 See, e.g., Fidelity Letter, supra note 86; USAA Letter, supra note 153.

266 See, e.g., CMFI Letter, supra note 44 (noting that the proposal to require that the SAI be made available through a Web site "will make it much easier for investors to review this document and become more knowledgeable about fund operations and management").

b. Formatting Requirements for Information Provided on the Internet

We are adopting, with modifications to reflect commenters' concerns, the proposed formatting requirements for the information that is required to be provided online. The proposed rule would have required, as a condition to reliance on the rule to satisfy a person's delivery obligations under Section 5(b)(2) of the Securities Act and the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act, that the information on the Internet be presented in a format that is convenient for both reading online and printing on paper.[267] In lieu of this condition, we are adopting a condition requiring that the information on the Internet be presented in a format that is human-readable and capable of being printed on paper in human-readable format.[268] We are also adopting a requirement that the information be in a format that is convenient for both reading online and printing on paper, but this requirement is not a condition to reliance on the rule to satisfy a person's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with the conditions to the rule will not violate Section 5(b)(2) if the "convenient for both reading online and printing on paper" standard is not satisfied, but this failure will constitute a violation of the Commission's rules.[269]

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267 Proposed rule 498(f)(2)(i). Cf. Rule 14a-16(c) under the Exchange Act [17 CFR 240.14a-16(c)] (requiring materials to be presented in a format convenient for both reading online and printing in paper when delivering proxy materials electronically).

268 Rule 498(e)(2)(i).

269 Rule 498(f)(3) and (5). This is similar to the "greater prominence" requirement discussed in Part III.B.1. above.

The condition that we are adopting, that information on the Internet be presented in a format that is human-readable and capable of being printed on paper in human-readable format, is a more objective standard than the proposed "convenient" condition. Commenters expressed concern about applying the proposed standard as a condition to satisfying Section 5 obligations.[270] The adopted condition simply makes clear that posted information must be presented in human-readable text, rather than machine-readable software code, when accessed through an Internet browser and that it must be printable in human-readable text. This condition does not impose any further requirements relating to user-friendliness of the presentation.

We are, however, retaining the standard that posted information be "convenient for both reading online and printing on paper" as a rule requirement. This implements the suggestion of commenters who criticized the "convenient" standard as a condition and suggested that it could, instead, be made a rule requirement.[271] This standard was designed to ensure that the information provided over the Internet is user-friendly, both online and when printed. It imposes on the online information a standard of usability that is comparable to the readability of a paper document. While we continue to believe that this standard is important to the enhanced disclosure framework we are adopting, we are persuaded by commenters that the consequence of failure to meet a condition – a Section 5 violation – is not needed to achieve our goal.

We are not, at this time, specifying that any particular format, such as HTML or PDF, would constitute a convenient format for both reading online and printing on

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270 See, e.g., ABA Letter, supra note 37; ICI Letter, supra note 34; NYC Bar Letter, supra note 75.

271 See, e.g., ABA Letter, supra note 37; ICI Letter, supra note 34.

paper.[272] We are concerned that the Commission's endorsement of any particular format could result in the use of that format to the exclusion of other formats that are in existence today or that may be developed in the future and that are more user-friendly. Moreover, whether a particular format is convenient for reading online and printing depends on a number of factors and must be decided on a case-by-case basis. These factors include the manner in which the online version renders charts, tables, and other graphics; the extent to which the fund utilizes search and other capabilities of the Internet to enhance investors' access to information and provides access to any software necessary to view the online version; and the time required to download the online materials.[273]

c. Technological Requirements for Online Information

We are adopting the proposed requirements for linking within the statutory prospectus and SAI and for linking between the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other. These requirements are intended to result in online information that is in a better and more useable format than the same information when provided in paper. The requirements were generally supported by commenters in concept, although, as discussed below, many expressed concern regarding

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272 See, e.g., ABA Letter, supra note 37 (arguing that the adopting release should state that a PDF format would constitute a "convenient" format for purposes of rule 498).

273 See Investment Company Act Release No. 27671 (Jan. 22, 2007) [72 FR 4148, 4154 (Jan. 29, 2007)]; Exchange Act Release No. 56135, supra note 29, 72 FR at 42224 n. 35 (guidance concerning "convenient for both reading online and printing on paper" standard in context of electronic delivery of proxies).

specific requirements under the proposal.[274] We are making several modifications to the requirements to address technical considerations raised by commenters.[275]

Linking within the Statutory Prospectus and SAI

We are adopting a requirement that persons accessing the statutory prospectus or SAI online be able to move directly back and forth between each section heading in a table of contents of the document and the section of the document referenced in that section heading. In the case of the statutory prospectus, the linked table of contents must be either the table of contents required by rule 481(c)[276] or a table of contents that contains the same section headings as the required table of contents.[277] This requirement allows an investor or other user to move directly between a table of contents of the prospectus or SAI and the related sections of that document, by a single mouse click and without the need to flip through multiple pages of a paper document.

This requirement includes two modifications from the proposed requirement. First, we are clarifying that the linked table of contents may be outside the document, e.g., in a separate frame or panel of the computer screen and need not be the table of contents that is contained within the document itself, as long as the linked table of contents for the statutory prospectus conforms to the table of contents that is required by

274 See, e.g., CMFI Letter, supra note 44; Data Communiqué Letter, supra note 35; ICI Letter, supra note 34; MFDF Letter, supra note 34.

275 We are not adopting the suggestion of one commenter that the Commission delay, or not apply, linking requirements with respect to funds that are offered through variable insurance contracts. See CAI Letter, supra note 67. While we recognize that there may be operational challenges associated with the offering of multiple funds from several fund families through a variable insurance contract, the linking requirements are an essential condition to permitting a person to satisfy its prospectus delivery obligations by sending or giving a Summary Prospectus.

276 17 CFR 230.481(c).

277 Rule 498(e)(2)(ii).

our rules to be contained within the document itself. This modification is intended to provide flexibility to use linking technologies other than hyperlinking within the document itself. Permitted technologies would include, for example, the use of "bookmarks" that replicate the document's table of contents, but are displayed in a separate panel from the document itself.[278] We have accomplished this clarification by modifying the language of the proposed requirement[279] to refer to "**a** table of contents **of**" the relevant document rather than "**the** table of contents **in**" the relevant document and by requiring that, in the case of the statutory prospectus, the linked table of contents either be the table of contents required by rule 481(c) or contain the same section headings as the table of contents required by that rule. Second, we are revising the rule language to clarify that the links must permit movement directly back and forth between each section heading in a table of contents and the particular section of the document referenced in that section heading.[280]

Linking Between Documents

We are also adopting a requirement for funds to comply with one of two options: that persons accessing the Summary Prospectus be able to move directly back and forth between either (i) each section of the Summary Prospectus and any section of the statutory prospectus and SAI that provides additional detail concerning that section of the Summary Prospectus; or (ii) links located at both the beginning and end of the Summary

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278 See, e.g., ICI Letter, supra note 34 (arguing that proposal should be revised to permit the use of bookmarks); Oppenheimer Letter, supra note 44 (same).

279 Proposed rule 498(f)(2)(ii).

280 See Oppenheimer Letter, supra note 44 (noting that the proposal could be read to require a viewer to be able to move from each section heading in the table of contents to each and every section of the document referenced in the table).

Prospectus, or that remain continuously visible to persons accessing the Summary Prospectus, and tables of contents of both the statutory prospectus and the SAI that meet the linking requirements described in the preceding section.[281] This requirement allows an investor to move back and forth between related sections of the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other, either directly through a single mouse click or indirectly by means of a table of contents of the prospectus or SAI, in which case two mouse clicks would be required.

We are adopting, as proposed, the first option, which permits movement between related sections of the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other, directly through a single mouse click.[282] Although a number of commenters suggested that this option is unlikely to be used as a result of the number of links that would be required to be maintained,[283] we believe that the option should remain available because the ability to single-click between related sections has the potential to result in an extremely user-friendly presentation.

We are, however, modifying the second proposed option, which involves linking between the Summary Prospectus and tables of contents of the statutory prospectus and SAI, in order to reduce the number of links that would be required.[284] As proposed, this

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281 Rule 498(e)(2)(iii). It is our intention that the ability to move between multiple windows that remain open simultaneously constitutes "back and forth" movement under this provision.

282 Rule 498(e)(2)(iii)(A); proposed rule 498(f)(2)(iii)(A).

283 See, e.g., AIM Letter, supra note 47; Capital Research Letter, supra note 34; ICI Letter, supra note 34; Janus Letter, supra note 63; MFS Letter, supra note 150; Oppenheimer Letter, supra note 44; T. Rowe Letter, supra note 49.

284 We are also making a technical modification to the rule to clarify that a linked table of contents must meet the requirements described in the preceding section, i.e., it must permit direct movement between each section heading in the table of contents and the section of the document referenced in that section heading and, in the case of the

option would have required links between each section of the Summary Prospectus and tables of contents in the statutory prospectus and SAI. This would potentially have required two links in each section of the Summary Prospectus (one for the statutory prospectus and one for the SAI). As adopted, this option will require either links located at both the beginning and end of the Summary Prospectus, or links that remain continuously visible to persons accessing the Summary Prospectus, perhaps in a separate panel or frame.[285] The number of links will be reduced, but their placement, either at the beginning and end of the Summary Prospectus or continuously visible, will ensure that they are prominent and readily accessible to investors. This modification responds to commenters' concerns that multiple links within the Summary Prospectus could result in a cluttered presentation, create mistaken expectations that the Summary Prospectus links would lead directly to related information rather than to tables of contents of the statutory prospectus and SAI, and would be expensive to maintain.[286]

Interactive Data

Some commenters urged the Commission to make greater use of technology to permit investors to access the specific information they need and to facilitate automated comparisons of data across multiple funds.[287] The Commission agrees with these commenters that technology holds great promise for enabling mutual fund investors to

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statutory prospectus, it must be the table of contents required by rule 481(c) or contain the same section headings as that table of contents. See rule 498(e)(2)(iii)(B) (requiring linked table of contents to meet requirements of paragraph (e)(2)(ii) of rule 498).

285 Rule 498(e)(2)(iii)(B).

286 See, e.g., Financial Services Roundtable Letter, supra note 246; ICI Letter, supra note 34; Janus Letter, supra note 63; MFS Letter, supra note 150; Oppenheimer Letter, supra note 44; Self Audit Letter, supra note 228.

287 See, e.g., Fund Democracy et al. Letter, supra note 34; Letter of Dominic Jones (Feb. 27, 2008) ("Jones Letter").

make better use of existing information to understand and compare funds. To that end, we note that the Commission has already proposed to require a significant portion of the information that is contained in the summary section of the statutory prospectus and the Summary Prospectus to be filed in interactive data format, which is intended to facilitate automated analysis and comparison of this information.[288] Accordingly, while we are taking a number of steps in the current rulemaking to make greater use of technology, we are considering additional steps, along the lines suggested by the commenters, in the context of the pending interactive data rulemaking. In addition, we recently undertook an initiative to fundamentally reexamine how we can make greater use of technology to deliver information to investors more effectively.[289]

d. Ability to Retain Documents

We are adopting the proposed requirement that persons accessing the Web site must be able to permanently retain, through downloading or otherwise, free of charge, an electronic version of the Summary Prospectus, statutory prospectus, SAI, and shareholder reports in a format that, like the online version, (i) is human-readable and capable of being printed on paper in human-readable format; and (ii) permits persons accessing the downloaded statutory prospectus or SAI to move directly back and forth between each section heading in a table of contents of that document and the section of the document referenced in that section heading.[290] The permanently retained document is not required

288 See Investment Company Act Release No. 28298, supra note 28, 73 FR at 35449.

289 See SEC Announces '21st Century Disclosure' Initiative to Fundamentally Rethink the Way Companies Report and Investors Acquire Information, Securities and Exchange Commission Press Release, June 24, 2008, available at http://www.sec.gov/news/press/2008/2008-119.htm.

290 Rule 498(e)(3). This requirement is identical to our proposal, except that the standards of clauses (i) and (ii) have been modified to reflect the parallel modifications that we made with respect to requirements for the online version. See discussion supra Part III.B.3.b.

to be in a format that allows an investor to move back and forth between the Summary Prospectus and the statutory prospectus and SAI because of technical difficulties associated with maintaining links between multiple downloaded documents.

Commenters generally expressed support for this proposal.[291] Two commenters suggested that rule 498 expressly provide that once a user saves a document, a fund is not responsible for maintaining the links that it contains to other documents and that failure to maintain a link will not provide a basis for liability.[292] We have determined that such a provision is unnecessary because we are not requiring downloaded documents to retain any links to other documents. In addition, as described above in Part III.B.3.c., we have revised the requirements for online linking between documents to permit the links to be external to the documents, in which case they would not even appear in the online versions of the documents.

e. Safe Harbor for Temporary Noncompliance

As discussed above, compliance with all of the conditions in rule 498 regarding Internet posting (other than the convenient for reading and printing standard) is required in order to meet prospectus delivery obligations under Section 5(b)(2) of the Securities Act. Failure to comply with any of these conditions will be a violation of Section 5(b)(2) unless the fund's statutory prospectus is delivered by means other than reliance on the

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and c. Persons accessing the materials must also be able to permanently retain, free of charge, an electronic version of the materials in a format, or formats, that are convenient for both reading online and printing on paper. This is a rule requirement and not a condition to satisfy a person's statutory prospectus delivery obligations under Section 5. Rule 498(f)(3)(ii). See discussion supra Part III.B.3.b.

291 See, e.g., Data Communiqué Letter, supra note 35; ICI Letter, supra note 34; Jones Letter, supra note 287; Schnase Letter, supra note 35; T. Rowe Letter, supra note 49.

292 See ICI Letter, supra note 34; T. Rowe Letter, supra note 49.

rule. The Commission recognizes, however, that there may be times when, due to events beyond a fund's control, such as system outages or other technological issues, natural disasters, acts of terrorism, or pandemic illnesses, a fund is temporarily not in compliance with the Internet posting requirements of the rule. For that reason, we are adopting the proposed safe harbor provision stating that the conditions regarding Internet availability of a fund's Summary Prospectus, statutory prospectus, SAI, and shareholder reports will be deemed to be met, notwithstanding the fact that those materials are not available for a time in the manner required, provided that the fund has reasonable procedures in place to ensure that those materials are available in the required manner. In addition, a fund is required to take prompt action to ensure that those materials become available in the manner required, as soon as practicable following the earlier of the time at which the fund knows or reasonably should have known that the documents are not available in the manner required.[293] The safe harbor, by its terms, is expressly applicable to the format, linking, and permanent retention conditions of the rule, in addition to the conditions requiring that the documents be available online.[294]

f. Requirement to Send Documents

We are adopting the proposed requirement that a fund (or financial intermediary through which shares of the fund may be purchased or sold) send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of the fund's statutory prospectus, SAI, and most recent annual and semi-annual shareholder

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293 Rule 498(e)(4). This safe harbor is not available to a fund that repeatedly fails to comply with the rule's Internet posting requirements or that is not in compliance with the requirements over a prolonged period.

294 Rule 498(e)(4) (safe harbor applies to conditions set forth in paragraphs (e)(1), (2), and (3) of rule 498).

report to any person requesting such a copy within three business days after receiving a request for a paper copy. We are also adopting, with one modification, the proposed requirement that a fund (or financial intermediary through which shares of the fund may be purchased or sold) send, at no cost to the requestor and by e-mail, an electronic copy of the fund's statutory prospectus, SAI, and most recent annual and semi-annual shareholder report to any person requesting such a copy within three business days after receiving a request for an electronic copy.[295] These requirements are intended to ensure that every investor in a fund taking advantage of the new prospectus delivery framework is permitted to choose whether to review a fund's information on the Internet or whether to receive that information directly, either in paper or through an e-mail. As a result of these requirements, each investor will have prompt access to the required information in the form that he or she prefers.

We are modifying the proposal, as suggested by one commenter,[296] to clarify that the requirement to send an electronic copy of a document by e-mail may be satisfied by sending a direct link to the document on the Internet, provided that a current version of the document is directly accessible through the link from the time that the e-mail is sent through the date that is six months after the date that the e-mail is sent and the e-mail explains both how long the link will remain useable and that, if the recipient desires to retain a copy of the document, he or she should access and save the document.[297] We believe that six months is a reasonable period of time to require the documents to be

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295 Rule 498(f)(1).

296 See ICI Letter, supra note 34.

297 Rule 498(f)(1). We intend that "current" means the updated version of a document, not an outdated version that was current at the time the e-mail was sent. This is similar to the meaning of "current" discussed above in Part III.B.3.a.

available and will provide sufficient time for an investor who has requested a copy to access and, if desired, download the information. We also note that an investor may at any time request to receive a paper copy of the documents.

As in the proposal, the requirement that a fund send a paper or electronic copy of the statutory prospectus, SAI, and most recent annual and semi-annual shareholder reports to a person requesting such a copy is not a condition to reliance on the rule to satisfy a fund's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with all other aspects of rule 498 will not violate Section 5(b)(2) of the Securities Act if the fund (or financial intermediary) fails to send the required paper or electronic copy of the statutory prospectus, SAI, and most recent shareholder reports. This failure will, however, constitute a violation of the Commission's rules.[298]

4. Incorporation by Reference

a. Permissible Incorporation by Reference

We are adopting, with modifications, the proposal to permit a fund to incorporate by reference into the Summary Prospectus information contained in its statutory prospectus, SAI, and shareholder reports.[299] The proposal would have permitted a fund to incorporate by reference information from the fund's most recent report to shareholders. As adopted, rule 498 permits a fund to incorporate by reference any information from the fund's reports to shareholders that the fund has incorporated by reference into its statutory prospectus. This modification addresses commenters'

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298 Rule 498(f)(5).

299 Rule 498(b)(3).

concerns that the proposal was overbroad[300] by limiting incorporation from shareholder reports to information that has been incorporated into the fund's statutory prospectus and, as a result, is subject to liability under Section 11 of the Securities Act.[301] The modification also addresses other commenters' concerns that funds be permitted to incorporate by reference information from both the most recent annual shareholder report and most recent semi-annual shareholder report[302] and will permit the Summary Prospectus to incorporate from shareholder reports precisely the same information that the statutory prospectus may incorporate today. Incorporation by reference is subject to the conditions described below.

A fund may not incorporate by reference into a Summary Prospectus information from any source other than those described above.[303] In addition, a fund may not incorporate by reference into the Summary Prospectus any of the information described above that is required to be included in the Summary Prospectus.[304] Information may be incorporated by reference into the Summary Prospectus only by reference to the specific document that contains the information, and not by reference to another document that incorporates the information by reference.[305] Thus, if a fund's statutory prospectus incorporates the fund's SAI by reference, the fund's Summary Prospectus could not

300 See Fund Democracy et al. Letter, supra note 34 (arguing there is no basis to extend incorporation by reference to annual report); Letter of Prof. Joseph A. Franco (Feb. 28, 2008) (incorporation by reference should be limited to the statutory prospectus).

301 15 U.S.C. 77k.

302 See ICI Letter, supra note 34.

303 Rule 498(b)(3)(i) and (ii).

304 Rule 498(b)(3)(ii)(B).

305 Rule 498(b)(3)(ii)(C).

incorporate information in the SAI simply by referencing the statutory prospectus but would be required to reference the SAI directly.[306]

Incorporation by reference of information from a fund's statutory prospectus, SAI, and shareholder reports is permitted only if the fund satisfies the conditions described above in Part III.B.3., which prescribe the means by which the incorporated information is provided to investors.[307] In addition, if a fund incorporates information by reference, the Summary Prospectus legend must specify the type of document (e.g., statutory prospectus) from which the information is incorporated and the date of the document. If a fund incorporates by reference a part of a document, the Summary Prospectus legend must clearly identify the part by page, paragraph, caption, or otherwise.[308] These document identification requirements have been modified from the proposal, which would have required that the legend clearly identify documents that are incorporated by reference, including the date of the documents, in order to make the

306 Cf. Item 10(d) of Regulation S-K [17 CFR 229.10(d)] ("Except where a registrant or issuer is expressly required to incorporate a document or documents by reference . . . reference may not be made to any document which incorporates another document by reference if the pertinent portion of the document containing the information or financial statements to be incorporated by reference includes an incorporation by reference to another document."). General Instruction D.2. of Form N-1A makes Item 10(d) of Regulation S-K applicable to incorporation by reference into a fund's statutory prospectus.

307 Rule 498(b)(3)(ii)(A) and (e). We note that the safe harbor described in Part III.B.3.e. stating that, under certain circumstances, the conditions regarding Internet availability of a fund's Summary Prospectus, statutory prospectus, SAI, and shareholder reports will be deemed to be met, notwithstanding the fact that those materials are not available for a time in the manner required, also applies to permit incorporation by reference in those circumstances. Rule 498(e)(4).

308 Rule 498(b)(1)(v)(B). This requirement is similar to the requirements of rule 411(d) under the Securities Act [17 CFR 230.411(d)], which requires that information incorporated by reference "be clearly identified in the reference by page, paragraph, caption or otherwise."

requirements more precise.[309] The legend is also required to explain that any information that is incorporated from the SAI or shareholder reports may be obtained, free of charge, in the same manner as the statutory prospectus.[310]

A fund that fails to comply with any of the above conditions may not incorporate information by reference into its Summary Prospectus. A fund that provides the incorporated information to investors by complying with all of the conditions, including the conditions for providing the incorporated information through the Internet, is not also required to send or give the incorporated information together with the Summary Prospectus.[311]

A significant number of commenters expressed support for the Commission's proposal to permit incorporation by reference of information from other fund documents into the Summary Prospectus.[312] Commenters stated that, by permitting incorporation by reference, the proposal significantly addresses liability issues that resulted in funds' unwillingness to use the fund profile and will encourage wider use of the Summary Prospectus.[313]

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309 See, e.g., ICI Letter, supra note 34; NYC Bar Letter, supra note 75.

310 Rule 498(b)(1)(v)(B) and (b)(3)(ii)(A).

311 Rule 498(b)(3)(i). Cf. General Instruction D.1.(b) of Form N-1A (permitting a fund to incorporate by reference any or all of the SAI into the statutory prospectus without delivering the SAI with the prospectus).

312 See, e.g., ABA Letter, supra note 37; CFA Institute Letter, supra note 37; Letter of Citigroup Global Markets Inc. (Feb. 26, 2008) ("Citigroup Letter"); Dechert Letter, supra note 50; ICI Letter, supra note 34; MFDF Letter, supra note 34; NYC Bar Letter, supra note 75; Oppenheimer Letter, supra note 44; Schnase Letter, supra note 35; SIFMA Letter, supra note 97; T. Rowe Letter, supra note 49.

313 See, e.g., ABA Letter, supra note 37; Citigroup Letter, supra note 312; ICI Letter, supra note 34; MFDF Letter, supra note 34; SIFMA Letter, supra note 97. See also AARP Letter, supra note 34 ("Various explanations have emerged as to why the fund profile did not take hold, including the rapid development of the Internet as a resource for mutual

A joint comment letter from three consumer and investor groups, however, stated that the Commission did not adequately address serious questions accompanying incorporation by reference in the proposing release.[314] These commenters argued, first, that the Commission did not adequately explain any purpose for permitting incorporation by reference other than the limitation of funds' liability. Second, the commenters argued that the Commission's proposal would relieve issuers of legal responsibility for misleading disclosure under Sections 12(a)(2) and 17(a)(2) of the Securities Act and that the proposing release had not discussed whether the benefits of having a Summary Prospectus that satisfies prospectus delivery obligations is worth the cost of relieving funds of this legal responsibility or whether such a tradeoff is appropriate.

With respect to the commenters' first concern, our purpose in permitting incorporation by reference into the Summary Prospectus is to further our goal of creating an improved mutual fund disclosure framework for the benefit of investors. We have concluded, and the comments and recent investor research support our conclusion, that investors will benefit greatly from receiving a shorter document, such as the Summary Prospectus. We have also concluded, based on both the comments and our experience with the fund profile that, to a significant extent, investors will not realize these benefits unless we permit incorporation by reference because many funds are unlikely to use the

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fund investors and liability concerns related to the profile. The proposal under consideration today addresses both issues, and as such, paves the way for more widespread use of the summary documents.").

314 See Fund Democracy et al. Letter, supra note 34. Another commenter opposed incorporation by reference into the Summary Prospectus, but noted that if incorporation by reference is permitted, the incorporated documents should be available on the Internet, linked with other documents, downloadable in printable form with retained links, and distributed upon request, similar to our proposal. See Data Communiqué Letter, supra note 35.

Summary Prospectus if incorporation by reference is prohibited. With respect to the commenters' second concern, we do not agree that permitting incorporation by reference will relieve funds of legal responsibility for misleading disclosure. Therefore, we believe that it is appropriate to permit incorporation by reference in order to realize for investors the considerable benefits that the Summary Prospectus will afford. We discuss our analysis more fully below.

Incorporation by Reference is Necessary to Improve Disclosure Framework

We have concluded that investors will benefit greatly from receiving the Summary Prospectus containing key information that they will be more likely to read and understand than the statutory prospectus, with the ability to access more detailed information either immediately in a user-friendly format online or, within a matter of days, in paper. Nearly all of the commenters, including those who opposed incorporation by reference, agreed with this conclusion.[315] This conclusion is also supported by our

[315] See AARP Letter, supra note 34 (stating that it is AARP's view that the Commission's initiative provides a real opportunity to deliver practical disclosure that consumers can use to make informed mutual fund purchase decisions); CMFI Letter, supra note 44 (stating that the new disclosure regime would help investors focus on what is most important in making investment decisions with respect to any particular fund and that the Summary Prospectus is much more likely to be reviewed by investors); Data Communiqué Letter, supra note 35 (acknowledging the improvements that will result from improved access and ease of comparability of relevant information in a concise format); Fund Democracy et al. Letter, supra note 34 (supporting Summary Prospectus proposal overall and agreeing that "a short form alternative to a lengthy statutory prospectus can both improve the quality and usefulness of fund disclosure and reduce fund expenses"); ICI Survey, supra note 84 (stating that respondents to a survey it conducted overwhelmingly agreed that the Summary Prospectus is about the right length, makes it easier to compare funds, contains enough information (as long as more detailed information is available online or upon request), and is a document that they would be more likely to use than the current long-form prospectus); Letter of William D. McAllister (Nov. 27, 2007) (stating that current disclosure statements are definitely unreadable for the average citizen investor and that the simplification proposed is needed and appreciated); Letter of Kyle N. Orlowski (March 10, 2008) (stating that the proposal would make an "apples to apples" comparison between funds much easier).

recent telephone survey of investors, which found that many mutual fund investors do not read statutory prospectuses because they are long, complicated, and hard to understand.[316]

The views expressed by investors in our focus groups also support our conclusion that investors will derive significant benefits from the Summary Prospectus, coupled with ready access to more detailed information in whatever format they choose, paper or electronic.[317] By using multiple means to provide information and by using technology to provide information in a layered format that permits users to move from key information to more detailed information, the new rule is intended to facilitate each investor's ability to effectively choose to review the particular information in which he or she is interested. Each investor in a fund taking advantage of the new prospectus delivery regime can choose the particular means of receiving information that he or she prefers because all of the information is required to be sent promptly to any requesting investor in paper or electronically. Thus, the Summary Prospectus disclosure framework will permit each and every investor to choose both the information he or she wants to review and the format in which he or she wants to review it.

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316 See Telephone Survey Report, supra note 32, at 56, 58 (finding that nearly two-thirds of investors rarely (28%), very rarely (15%), or never (21%) read mutual fund statutory prospectuses that they receive, and that of those two-thirds, over half said that the reason they do not read them was because statutory prospectuses are too complicated or hard to understand (37%) or because statutory prospectuses are too long and wordy (19%)).

317 See Focus Group Report, supra note 32, at 5-6 (noting that participants made numerous negative comments about the length of the long-form prospectus and that many participants liked the short-form prospectus and thought that it could be used as a screening tool to identify mutual funds in which they might be sufficiently interested to do some additional review); Focus Group Transcripts, supra note 32, at 63 ("It's a two-minute read. If I want more information, I can ask for it."); id. at 38 ("I think both [the long-form prospectus and short-form prospectus] have their place. I think it would be foolish to give up the long-form for 'this' and I think it would be foolish not to have the short-form and insist on a long-form. They both have their place.").

We also believe that significantly more funds and intermediaries will utilize the Summary Prospectus if we permit funds to incorporate by reference information from the funds' statutory prospectus, SAI, and shareholder reports. Numerous commenters stated that, by permitting incorporation by reference, the proposal significantly addresses liability issues that resulted in funds' unwillingness to use the fund profile and will encourage wider use of the Summary Prospectus.[318] Our own experience with the fund profile over the past 10 years confirms that very few funds have adopted it.[319] We believe that one of the principal reasons for the profile's low adoption rate is concern about potential liability for omitting facts from the profile that are contained in the statutory prospectus or SAI.[320] While we acknowledge that an additional contributing factor was the requirement that funds using the profile also provide a statutory prospectus with the confirmation,[321] we do not believe that elimination of this requirement alone, without permitting incorporation by reference, would result in widespread use of the Summary Prospectus by funds.

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318 See letters cited supra note 313.

319 Profiles were filed for less than 200 funds during calendar year 2007. During 2007, there were almost 9,000 mutual funds in existence. See 2008 ICI Fact Book, supra note 16, at 15.

320 See letters cited supra note 313. See also Tom Leswing, Profile Prospectus Rule Expected Soon, IGNITES (Mar. 28, 2007) (panelists at the ICI Mutual Funds and Investment Management Conference expressed concern about liability for using a short-form prospectus and noted that concern about liability was the main reason that few funds use the profile); NASD Mutual Fund Task Force Report, supra note 19, at 5 ("To date, few mutual funds have used the fund profile in the retail market. One concern that has been voiced about the fund profile is that it could expose funds to unforeseen liability. For example, by summarizing disclosure that appeared in the full prospectus, some fear that the fund profile could be deemed to have omitted material information.").

321 See Fund Democracy et al. Letter, supra note 34.

Thus, permitting incorporation by reference into the Summary Prospectus is essential to accomplishing the Commission's important goal of encouraging use of a disclosure document that provides key information that investors are more likely to read and understand than the statutory prospectus. Commenters and investor testing consistently affirm the importance of the goal and of the Summary Prospectus in achieving the goal. Commenters on the current proposal, and our experience with the profile, confirm that we cannot accomplish the goal without permitting incorporation by reference.

Investor Protection

We have also concluded that permitting incorporation by reference will not relieve funds of any legal responsibility for misleading disclosure under Sections 12(a)(2) and 17(a)(2) of the Securities Act.[322] As a result, we have concluded that it is appropriate to permit incorporation by reference in order to realize for investors the considerable benefits that the Summary Prospectus will afford.

The Summary Prospectus, together with information incorporated therein by reference, is subject to liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act, and nothing in rule 498 removes, or diminishes, that liability. Under Section 12(a)(2) of the Securities Act, sellers have liability to purchasers for offers or sales by means of a prospectus or oral communication that includes an untrue statement of material fact or omits to state a material fact that makes the statements made, based on the circumstances under which they were made, not misleading. Section 17(a)(2) of the Securities Act is a general antifraud provision which makes it unlawful for any person in the offer and sale

[322] We also note that rule 498 does not reduce, or otherwise affect, liability under Section 11 of the Securities Act. This is discussed in Part III.B.5.

of a security to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

We are permitting incorporation by reference of the statutory prospectus, SAI, and information from the shareholder reports that is incorporated into the statutory prospectus in order to reflect, as a legal matter, the practical reality that, under the conditions of rule 498, the information incorporated into the Summary Prospectus will be provided at the same time as the Summary Prospectus though by different means.[323] Funds and other sellers will be liable under Sections 12(a)(2) and 17(a)(2) for information incorporated by reference into the statutory prospectus. Investors who choose to review the statutory prospectus, SAI, and shareholder reports in paper will have the same ability to do so that they do today. In addition, rule 498 requires that all information contained in the Summary Prospectus, statutory prospectus, SAI, and shareholder reports be immediately available to investors online in a user-friendly format.[324] By using multiple means to provide this information and using technology to provide information in a layered format, the new rule is intended to facilitate investors' ability to easily access and review the particular information in which they are interested. Indeed, each investor in a fund taking advantage of the new prospectus delivery regime can choose the particular means of receiving information because all of the information is

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323 Thus, rule 498(b)(3)(iii) expressly provides that incorporated information is, for purposes of rule 159 (and therefore for purposes of Sections 12(a)(2) and 17(a)(2) of the Securities Act), conveyed not later than the time the Summary Prospectus is received. See discussion infra Part III.B.4.b.

324 The provisions that we are adopting requiring linking within and between documents and that the documents be in a format that is convenient for both reading online and printing on paper are intended to contribute to a user-friendly online presentation. Rule 498(e)(2)(ii), (e)(2)(iii), and (f)(3).

required to be promptly sent to any requesting investor in paper or electronically. The Summary Prospectus disclosure regime enhances the accessibility of the information that is available to investors and increases their options for how to receive the information; it does not take away any information or any option for the method by which information is received.

Our determination to permit incorporation by reference of information into the Summary Prospectus is different from the determination we made with respect to the profile and is made in light of technological advances that have occurred during the intervening years. When the Commission adopted the profile more than 10 years ago, it did not permit incorporation by reference of the statutory prospectus into the profile and stated its belief that allowing this incorporation would be inconsistent with the purpose of the profile and not in the public interest.[325] The Commission noted that the profile was designed to provide summary information about a fund in a self-contained format and that permitting incorporation by reference of the statutory prospectus would be inconsistent with the profile being a self-contained document.[326]

By contrast, the Summary Prospectus is not a self-contained document, but rather one element in a layered disclosure regime that is intended to provide investors with better, more useable access to the information in the statutory prospectus, SAI, and shareholder reports than they have today. The expansion in Internet access and the strides in the speed and quality of Internet connections since the profile rule was adopted

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325 Investment Company Act Release No. 23065, supra note 194, 63 FR at 13971.

326 Id.

in 1998 have made this possible.[327] As a result of these considerations and for the other reasons discussed above, we believe that it is consistent with the purpose of the Summary Prospectus and in the public interest to permit incorporation by reference of information from the statutory prospectus, SAI, and shareholder reports into the Summary Prospectus, subject to the conditions to incorporation by reference contained in rule 498.

b. Effect of Incorporation by Reference

We are adopting, as proposed, the provision of rule 498 stating that, for purposes of rule 159 under the Securities Act,[328] information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with rule 498. This provision addresses the question of when information that is incorporated into the Summary Prospectus under rule 498 is conveyed for purposes of Sections 12(a)(2) and

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327 See, e.g., AARP Letter, supra note 34 (noting that "the growth of the Internet as an information source has dramatically improved investors' access to mutual fund information"); CFA Institute Letter, supra note 37 ("In a time of electronic accessibility, this approach is in keeping with movement taken by the SEC through other proposals to streamline the process and reduce expenses to investment companies, while preserving investor protections."). In 1998, one study indicated that over one-third of Americans over the age of 16 used the Internet. Associated Press Online, One-Third of Americans Use Internet (Aug. 25, 1998). As noted above, our recent telephone survey indicates that 90% of investors have Internet access. Telephone Survey Report, supra note 32, at 115. See also 2008 ICI Fact Book, supra note 16, at 80-81 (noting that more than nine in 10 U.S. households owning mutual funds have Internet access, up from two-thirds in 2000; 69 percent of mutual fund shareholders age 65 or older have Internet access, up from 30 percent in 2000; and about eight in 10 mutual fund shareholders with Internet access go online for financial purposes, such as to check their bank or investment accounts, obtain investment information, or buy or sell investments). Moreover, very few American homes had broadband connections in 1998. See Robert J. Samuelson, Broadband's Faded Promise, THE WASHINGTON POST, at A35 (Dec. 12, 2001) (noting that almost no American homes had broadband in 1998). In contrast, as of early 2007, nearly half of all adult Americans had a broadband connection at home. See supra note 26. See also Jesse Noyes, Broadband signals death of dial-up, THE BOSTON HERALD, at 028 (Aug. 7, 2005) (noting that dial-up speeds have remained constant at 56K since 1998 and cannot go higher, while broadband speeds have grown from 1 megabyte per second to 100 megabytes a second in the past six years).

328 17 CFR 230.159.

17(a)(2) of the Securities Act. Commenters who addressed this provision generally supported the position that all information that is properly incorporated by reference into the Summary Prospectus is conveyed to an investor for purposes of these sections.[329]

As we have previously stated, we interpret Section 12(a)(2) and Section 17(a)(2) to mean that, for purposes of assessing whether at the time of sale (including a contract of sale) a prospectus or oral communication or statement includes or represents a material misstatement or omits to state a material fact necessary in order to make the prospectus, oral communication, or statement, in light of the circumstances under which it was made, not misleading, information conveyed to the investor only after the time of sale (including a contract of sale) should not be taken into account.[330] In furtherance of this interpretation, we adopted rule 159 under Sections 12(a)(2) and 17(a)(2). Consistent with our interpretation, rule 159 provides that, for purposes of Sections 12(a)(2) and 17(a)(2) only, and without affecting any other rights under those sections, for purposes of determining at the time of sale (including the time of the contract of sale) whether a prospectus, oral statement, or a statement[331] includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in light of the

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329 See, e.g., ABA Letter, supra note 37; Dechert Letter, supra note 50; ICI Letter, supra note 34; Schnase Letter, supra note 35; T. Rowe Letter, supra note 49. As discussed more fully in Part III.B.4.a., several commenters disagreed with the Commission's determination to permit incorporation by reference.

330 See Securities Act Release No. 8591 (Jul. 19, 2005) [70 FR 44722, 44766 (Aug. 3, 2005)].

331 These include a prospectus or oral statement in the case of Section 12(a)(2), or a statement to which Section 17(a)(2) is applicable.

circumstances under which they were made, not misleading,[332] any information conveyed to the purchaser only after the time of sale will not be taken into account.

Rule 498 provides that, for purposes of rule 159 (and therefore for purposes of Sections 12(a)(2) and 17(a)(2)), information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with the rule.[333] For purposes of Sections 12(a)(2) and 17(a)(2), whether or not information has been conveyed to an investor at or prior to the time of the contract of sale is a facts and circumstances determination.[334] We have designed the requirements of rule 498 specifically so that the facts and circumstances surrounding receipt by a person of the Summary Prospectus will, in fact, result in the effective conveyance to that person of any information that is incorporated by reference into the Summary Prospectus in compliance with the conditions of the rule. For that reason, rule 498 expressly states that, for purposes of rule 159, information incorporated into a Summary Prospectus is conveyed not later than the time that the Summary Prospectus is received.[335] The relevant facts and circumstances required by rule 498 include actual receipt of the Summary Prospectus;

332 Or, in the case of Section 17(a)(2), any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

333 Rule 498(b)(3)(iii).

334 See Securities Act Release No. 8591, supra note 330, 70 FR at 44766. Such information could include information in the issuer's registration statement and prospectuses for the offering in question, the issuer's Exchange Act reports incorporated by reference therein, or information otherwise disseminated by means reasonably designed to convey such information to investors. Such information also could include information directly communicated to investors.

incorporation by reference of the information into the Summary Prospectus and clear disclosure of how the incorporated information may be obtained free of charge; and continuous Internet availability of the incorporated information in formats that permit permanent retention, are human-readable and capable of being printed on paper in human-readable format, and meet the document linking requirements of the rule.[336]

We are not adopting the suggestion of two commenters that rule 498 state that information is conveyed to a person not later than the time that the Summary Prospectus is conveyed to the person, rather than received by the person.[337] We are unable to conclude that, in all circumstances, information incorporated into a Summary Prospectus has been conveyed to an investor before the investor has received the Summary Prospectus.

Rule 498 addresses one particular set of facts and circumstances under rule 159 and does not address any other situations. For purposes of Sections 12(a)(2) and 17(a)(2), whether or not information has been conveyed to an investor at or prior to the time of the contract of sale remains a facts and circumstances determination. Rule 498 does not address any facts and circumstances relating to operating companies or any other issuers that are not mutual funds, nor does it address any information other than

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335 Whether or not any or all of the incorporated information was conveyed to an investor prior to the time that the Summary Prospectus was received will be a facts and circumstances determination.

336 Cf. Investment Company Act Release No. 13436 (Aug. 12, 1983) [48 FR 37928, 37930 (Aug. 22, 1983)] (discussing incorporation by reference of the SAI into the statutory prospectus); see also White v. Melton, 757 F. Supp. 267, 272 (S.D.N.Y. 1991) (addressing effect of incorporation by reference of the SAI into the statutory prospectus).

337 See ICI Letter, supra note 34; Schnase Letter, supra note 35.

information incorporated by reference into a mutual fund Summary Prospectus in accordance with the new rule.

The Commission believes that a person that provides investors with a mutual fund Summary Prospectus in good faith compliance with rule 498 will be able to rely on Section 19(a) of the Securities Act[338] against a claim that the Summary Prospectus did not include information that is disclosed in the fund's statutory prospectus, whether or not the fund incorporates the statutory prospectus by reference into the Summary Prospectus.[339] Section 19(a) protects a defendant from liability for actions taken in good faith in conformity with any rule of the Commission.[340]

5. Filing Requirements for the Summary Prospectus

We are requiring each Summary Prospectus to be filed with the Commission on EDGAR no later than the date that it is first used, rather than, as proposed, the fifth business day after the date that it is first used.[341] We agree with commenters who suggested that the Summary Prospectus should be filed with the Commission and be available on the Commission's Web site earlier than the fifth business day after it is first used.[342] In addition, we do not believe that the proposed five-day lag between first use of

338 15 U.S.C. 77s(a).

339 Cf. Investment Company Act Release No. 23065, supra note 194, 63 FR at 13972 (similar Commission statement in context of profile).

340 See also Section 38(c) of the Investment Company Act [15 U.S.C. 80a-37(c)] (similar provision under Investment Company Act).

341 Rule 497(k). As proposed, we are deleting the reference to the profile from rule 497(a) [17 CFR 230.497(a)].

342 See Bo Li Letter, supra note 35; NewRiver Letter, supra note 228. Two commenters supported the Commission's proposal to require each Summary Prospectus to be filed with the Commission no later than the fifth business day after first use. See ICI Letter, supra note 34; Schnase Letter, supra note 35.

a Summary Prospectus and filing is necessary, given that we are requiring that the Summary Prospectus be updated only once a year, at the same time that a fund files its updated statutory prospectus. A Summary Prospectus that is filed on EDGAR will be publicly available; however, a fund may not rely on this availability to satisfy the requirements to post the document online discussed in Part III.B.3. above.

Section 10(b) of the Securities Act provides that a prospectus permitted under that section shall, unless provided otherwise by Commission rule, be filed as part of the registration statement but shall not be deemed part of the registration statement for the purposes of Section 11 of the Securities Act.[343] In accordance with Section 10(b), a Summary Prospectus will be filed as part of the registration statement, but will not be deemed a part of the registration statement for purposes of Section 11 of the Securities Act.

A joint comment letter from three consumer and investor groups expressed concerns that the Summary Prospectus would not be subject to Section 11 liability, suggesting that this would result in a diminution of funds' liability under that section.[344] We emphasize that the registration statement of a fund that uses the Summary Prospectus will remain subject to liability under Section 11, as is the case today. All of the information that may be included in, or incorporated by reference into, a fund's Summary Prospectus is also required to be included in the fund's registration statement. Thus, as described more fully in the following paragraph, all information included in, or

[343] 15 U.S.C. 77j(b) and 77k.

[344] See Fund Democracy et al. Letter, supra note 34. Under Section 11 of the Securities Act [15 U.S.C. 77k], purchasers of an issuer's securities have private rights of action for untrue statements of material facts or omissions of material facts required to be included in the registration statement or necessary to make the statements in the registration statement not misleading.

incorporated by reference into, the Summary Prospectus will be subject to liability under Section 11 of the Securities Act.

As described in Part III.B.2.a., we are adopting a new requirement to clarify that the information contained in a Summary Prospectus that is used to satisfy prospectus delivery obligations must be the same as the information contained in the summary section of the fund's statutory prospectus. This information is, and will remain, subject to Section 11 liability because the fund's prospectus, in its entirety, is subject to Section 11 liability. In addition, information may be incorporated by reference into a Summary Prospectus only if it is contained in the fund's statutory prospectus, SAI, or has been incorporated into the statutory prospectus from the shareholder reports. That is, information that may be incorporated by reference into the Summary Prospectus is already a part of the fund's registration statement and, as a result, is subject in its entirety to liability under Section 11. Thus, while Section 10(b) of the Securities Act prescribes that the Summary Prospectus will not itself be deemed a part of the registration statement for purposes of Section 11, all of the information in the Summary Prospectus will be subject to liability under Section 11, either because the information is the same as information contained in the statutory prospectus or because the information is incorporated by reference from the registration statement.

We also note that a Summary Prospectus is subject to the stop order and other administrative provisions of Section 8 of the Securities Act.[345] This is in addition to the

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[345] 15 U.S.C. 77h; H.R. Rep. 1542, 83d Cong., 2d Sess., 1954 U.S.C.C.A.N. 2973, 2982 (1954) (noting that the Commission's authority to suspend the use of a defective summary prospectus under Section 10(b) "is intended to supplement the stop-order powers of the Commission under [S]ection 8").

Commission's power under Section 10(b) of the Securities Act to prevent or suspend the use of the Summary Prospectus, regardless of whether or not it has been filed.[346]

C. Technical and Conforming Amendments

We are adopting the following conforming amendments to rule 482 under the Securities Act, the investment company advertising rule, to reflect the Summary Prospectus and the elimination of the voluntary profile.

- The scope section of rule 482 is revised to clarify that the rule does not apply to a Summary Prospectus or to a communication that, pursuant to rule 498, is not deemed a "prospectus" under section 2(a)(10) of the Securities Act.[347]
- For funds using the Summary Prospectus, the legend required in a rule 482 advertisement regarding the availability of the statutory prospectus will be required to include references to the Summary Prospectus.[348]
- The provision addressing the use of rule 482 advertisements together with a profile that includes an application to purchase shares is deleted as unnecessary.[349]

We are also adopting amendments to various cross-references to Form N-1A in our rules and forms to reflect changes that we are adopting to Form N-1A. These include cross-references in rule 485 under the Securities Act, rules 304 and 401 of Regulation S-T, Form N-4 under the Securities Act and the Investment Company Act, and Form

346 15 U.S.C. 77j(b).

347 Rule 482(a).

348 Rule 482(b)(1).

349 Rule 482(c).

N-14 under the Securities Act. We are also revising rule 159A under the Securities Act to refer to a Summary Prospectus rather than a profile.

D. Compliance Date

As discussed in the proposing release, the Commission is providing for a transition period after the effective date of the amendments to Form N-1A that gives funds sufficient time to update their prospectuses or to prepare new registration statements under the revised Form N-1A requirements. The effective date of the amendments is March 31, 2009.

All initial registration statements on Form N-1A, and all post-effective amendments that are annual updates to effective registration statements on this form, filed on or after January 1, 2010, must comply with the amendments to Form N-1A. All post-effective amendments that add a new series, filed on or after January 1, 2010, must comply with the amendments with respect to the new series. The final compliance date for filing amendments to effective registration statements to comply with the new Form N-1A requirements is January 1, 2011. Based on the comments, we believe that this will provide adequate time for funds to compile and review the information that must be disclosed.[350] A fund may, at its option, prepare documents in accordance with the requirements of Form N-1A, as amended, at any time after the effective date of the amendments. A person may not rely on rule 498 to satisfy its obligations to deliver a mutual fund's statutory prospectus unless the fund is also in compliance with the amendments to Form N-1A.

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350 A number of commenters expressed the view that a one-year transition period was needed to make the required disclosure changes and implement the business process changes associated with use of the Summary Prospectus. See e.g., ICI Letter, supra note 34; Janus Letter, supra note 63; Oppenheimer Letter, supra note 44.

Post-effective amendments to existing registration statements filed to comply with the amendments to Form N-1A should be filed under Securities Act rule 485(a).[351] However, in appropriate circumstances, we will consider requests by existing funds to file these post-effective amendments pursuant to Securities Act rule 485(b)(1)(vii).[352] Appropriate circumstances may include, for example, situations where a fund complex has previously filed under rule 485(a) post-effective amendments for a number of funds that implement the new requirements, and the staff determines not to review additional such filings by the fund complex in light of the staff's experience with the previously filed amendments.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[353] The titles for the collections of information are: (1) "Form N-1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies" (OMB Control No. 3235-0307) and (2) "Summary Prospectus for Open-End Management Investment Companies" (OMB Control No. 3235-

[351] A post-effective amendment filed under rule 485(a) [17 CFR 230.485(a)] generally becomes effective either 60 days or 75 days after filing, unless the effective date is accelerated by the Commission. A post-effective amendment filed under rule 485(b) may become effective immediately upon filing. A post-effective amendment may be filed under rule 485(b) if it is filed for one or more specified purposes, including to make non-material changes to the registration statement. A post-effective amendment filed for any purpose not specified in rule 485(b) generally must be filed pursuant to rule 485(a).

[352] Under rule 485(b)(1)(vii), the Commission may approve the filing of a post-effective amendment to a registration statement under rule 485(b) for a purpose other than those specifically enumerated in the rule. The Commission's staff has been delegated the authority to approve registrants' requests under rule 485(b)(1)(vii). 17 CFR 200.30-5(b-3)(1).

[353] 44 U.S.C. 3501 et seq.

0637). We published notice soliciting comments on the collection of information requirements in the release proposing the amendments[354] and submitted the proposed collections of information to the Office of Management and Budget ("OMB") for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Four commenters specifically addressed the collection of information requirements and we have revised the proposed rule amendments in response to those comments.[355] We have also revised the estimated reporting and cost burdens of the rule amendments to address these comments, as discussed below.

Form N-1A under the Securities Act and the Investment Company Act[356] is used by mutual funds to register under the Investment Company Act and to offer their securities under the Securities Act. Rule 498 under the Securities Act will be used by mutual funds that choose to send or give a Summary Prospectus to investors.[357] 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. Because we have modified our proposals as described above, we are revising the burden estimate for Form N-1A and rule 498. We have submitted a revised request for both to OMB.

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354 See Proposing Release, supra note 12, 72 FR at 67809.

355 See American Century Letter, supra note 48; Capital Research Letter, supra note 34; Janus Letter, supra note 63; ICI Letter, supra note 34.

356 17 CFR 239.15A; 17 CFR 274.11A.

357 A request has been submitted to OMB to remove the collection of information for the fund profile, which is being eliminated, under current rule 498.

We are adopting an improved mutual fund disclosure framework that we originally proposed in November 2007.[358] This improved disclosure framework is intended to provide investors with information that is easier to use and more readily accessible, while retaining the comprehensive quality of the information that is available today. The foundation of the improved disclosure framework is the provision to all investors of streamlined and user-friendly information that is key to an investment decision.

To implement the new disclosure framework, we are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus will be provided on an Internet Web site. Funds that select this option will also be required to send the statutory prospectus to the investor upon request.

We are also adopting technical and conforming amendments to rules 159A and 482 under the Securities Act that reflect the Summary Prospectus and the elimination of the voluntary profile, along with amendments that update the cross references to Form N-1A contained in rule 485 under the Securities Act, rules 304 and 401 of Regulation S-T, Form N-4 under the Securities Act and the Investment Company Act, and Form N-14 under the Securities Act. These technical and conforming amendments do not

358 See Proposing Release, supra note 12, 72 FR at 67990.

constitute a collection of information because we are not altering the legal requirements of these rules and forms.

Finally, amendments to rule 497 provide the requirements for filing Summary Prospectuses with the Commission. These amendments do not constitute a separate collection of information under rule 497 because the burden required by these amendments is part of the collection of information under rule 498.

A. Form N-1A

Form N-1A, including the amendments, contains collection of information requirements. The likely respondents to this information collection are open-end management investment companies registered or registering with the Commission. Compliance with the disclosure requirements of Form N-1A is mandatory. Responses to the disclosure requirements are not confidential.

Much of the information that is required in the summary section of the prospectus under the amendments has previously been required in a fund's prospectus. However, the amendments require new information regarding the exchange ticker symbol and the compensation received by financial intermediaries. In addition, except for some information common to multiple funds, the summary section must be presented separately for each fund covered by a multiple fund prospectus. As a result, the amendments to Form N-1A may require additional burden hours to compile, review, and present the required information in a separate summary section for each fund. We estimate that the amendments will increase the hour burden per portfolio per filing of an initial registration statement or the initial creation of a post-effective amendment to a registration statement by approximately 17 hours.

In the proposing release, we estimated that the proposed amendments would increase the hour burden per portfolio per filing of an initial registration statement or the initial creation of a post-effective amendment to a registration statement by approximately 16 hours.[359] We received two comments on this estimate.[360] One commenter anticipated approximately 19,000 hours for its 75 funds, or over 253 hours per portfolio, to initially comply with the proposed amendments.[361] Another commenter, who conducted a survey of mutual fund complexes, estimated that the amendments would increase the hour burden per portfolio by 17 hours.[362] Recognizing that the commenter surveyed a broad cross-section of the mutual fund industry, and having reviewed the specific questions it asked respondents, we have incorporated this estimate in our analysis.[363]

We estimate, as we did in the proposing release, that subsequent post-effective amendments to a registration statement will require, on average, approximately 4 burden hours per portfolio to update and review the information.[364] We received one comment, which estimated that ongoing compliance with the proposed amendments to Form N-1A

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359 Proposing Release, supra note 12, 72 FR at 67808.

360 See Janus Letter, supra note 63; ICI Letter, supra note 34.

361 Janus Letter, supra note 63. The commenter did not, however, indicate what percentage of the 19,000 hours it would dedicate to compliance with the proposed amendments to Form N-1A and what percentage it would dedicate to compliance with proposed rule 498.

362 ICI Letter, supra note 34. The commenter estimated that the 42 fund complexes it surveyed offer 3,122 funds, accounting for nearly 60 percent of total mutual fund industry assets as of December 2007.

363 Although the final rule eliminates disclosure of portfolio holdings in the summary section, we believe that the 17 hours estimated by the commenter based on its survey remains reasonable.

364 See Proposing Release, supra note 12, 72 FR at 67808.

would require an average of 9 hours per fund.[365] However, we believe that the commenter based this estimate on responses to an ambiguous survey question.[366] We believe that respondents may have interpreted this question to ask how many hours it would take them to update and review all information each year to comply with Form N-1A rather than only how many additional hours it would take them each year to update and review information to comply with the amended items in Form N-1A.[367] For this reason, we are not adjusting our original burden hour estimate.

Because the PRA estimates represent the average burden over a three-year period, we estimate the average hour burden for one portfolio to comply with the amendments to be approximately 8 hours.[368] We estimate that 8,752 portfolios file initial registration statements and post-effective amendments on Form N-1A.[369] Thus, the incremental hour burden resulting from the amendments relating to the summary section disclosure would be 70,016 hours.[370] The total annual hour burden for all funds for preparation and filing

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365 See ICI Letter, supra note 34.

366 See id. (asking survey respondents, "How much time (in hours) would you estimate that it would take to update and review the information each year for Form N-1A on an **on-going** basis for all of your funds?" (bold in original)).

367 The respondents estimated that initial compliance with the Form N-1A amendments, including the creation of separate summaries for funds in a multiple fund prospectus, would require an average of 17 hours per fund, whereas ongoing compliance would average 9 hours per fund. See ICI Letter, supra note 34. Once such summary sections have been created, we do not believe that an update of such information on an annual basis should require more than half the time it takes to initially compile, review, and present that information in the summary section.

368 (17 hours in the first year + 4 hours in the second year + 4 hours in the third year) ÷ 3 years = approximately 8 hours.

369 See 2008 ICI Fact Book, supra note 16, at 15. In the Proposing Release, based on information in the 2007 version of the ICI Fact Book, we assumed that there were 8,726 portfolios. See Proposing Release, supra note 12, 72 FR at 67990 n. 14.

370 8 hours x 8,752 portfolios.

of registration statements and post-effective amendments to Form N-1A would be approximately 1,645,200 hours.[371]

B. Rule 498

Rule 498 contains collection of information requirements. The likely respondents to this information collection are open-end management investment companies registered or registering with the Commission. Under rule 498, use of the Summary Prospectus is voluntary, but the rule's requirements regarding provision of the statutory prospectus are mandatory for funds that elect to send or give a Summary Prospectus in reliance upon rule 498. The information provided under rule 498 will not be kept confidential.

We estimate that for those funds that choose to use the Summary Prospectus, initial compliance with the requirements for the Summary Prospectus will require approximately 23 burden hours per portfolio. We originally assumed in the proposing release that rule 498 would not impose any substantial new information collection requirements with respect to the initial preparation of a Summary Prospectus beyond those discussed above in connection with the collection of information for Form N-1A.[372] One commenter suggested that initial compliance with requirements for the Summary Prospectus and the other provisions of rule 498 would require approximately 23 burden hours per portfolio.[373] The commenter pointed out that initial compliance with the requirements for the Summary Prospectus would include, among other things, a document design process to create the Summary Prospectus; technology requirements for

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371 70,016 hours + 1,575,184 hours. Currently, the approved annual hour burden for preparing and filing registration statements on Form N-1A is 1,575,184 hours.

372 See Proposing Release, supra note 12, 72 FR at 67809.

373 See ICI Letter, supra note 34.

posting documents on funds' websites and providing hyperlinks within and between certain documents; and communication with distribution channels regarding the use of the Summary Prospectus.[374] Recognizing that we may have underestimated the costs associated with initial compliance with rule 498 and that the commenter based its estimate on a survey of a broad cross-section of the mutual fund industry, we have added an estimate of 23 burden hours necessary for initial compliance with rule 498.

In addition to initial compliance, we estimate, as we did in the proposing release, that rule 498 will impose a ½ hour burden per portfolio annually associated with the compilation of the additional information required on a cover page or at the beginning of the Summary Prospectus.[375] Rule 498 also imposes annual hour burdens associated with the posting of a fund's Summary Prospectus, statutory prospectus, SAI, and most recent report to shareholders on an Internet Web site.[376] We estimate that the average hour burden for one portfolio to comply with the Internet Web site posting requirements will be approximately one hour annually.[377]

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374 See id.

375 See Proposing Release, supra note 12, 72 FR at 67809.

376 Rule 498, as proposed, also would have imposed an annual hour burden associated with updating the Summary Prospectus every quarter. In the Proposing Release, we estimated that quarterly updating would impose approximately 3 burden hours per quarter per portfolio, or 9 hours annually for each of the three subsequent quarters. See Proposing Release, supra note 12, 72 FR at 67809. However, we are not including quarterly updating requirements in the final rule.

377 See Proposing Release, supra note 12, 72 FR at 67809. We have reduced this figure from the 4 hour estimate we made in the Proposing Release because we have not included quarterly updating requirements in the final rule. We originally estimated that Internet Web site posting would require approximately 1 hour per quarter, but without quarterly updating, we estimate that it will require 1 hour annually.

We received four comments on our original estimates of the burden of ongoing compliance. See American Century Letter, supra note 48; Capital Research Letter, supra note 34; Janus Letter, supra note 63; ICI Letter, supra note 34. One commenter estimated

Because the PRA estimates represent the average burden over a three-year period, we estimate the average hour burden for one portfolio to comply with the amendments to be approximately 9 hours.[378] The Summary Prospectus is voluntary, so the percentage of funds that will choose to provide it is uncertain. Given the potential benefits of the amendments to funds, we assume that 80% of all funds will choose to send or give the Summary Prospectus.[379] Assuming 80% of all funds file a Summary Prospectus, the total annual hour burden for filing and updating Summary Prospectuses and posting the required disclosure documents to an Internet Web site pursuant to rule 498 would be approximately 63,014 hours.[380]

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that filing Summary Prospectuses for its funds would require approximately 1150 hours per quarter, or 11 hours per fund. See American Century Letter, supra note 48. The second commenter estimated that the proposed quarterly updating requirement would require its 75 funds to spend approximately 5,300 burden hours. See Janus Letter, supra note 63. The third commenter estimated that it would spend an additional 4,400 hours per year to comply with the proposed quarterly updating requirements. See Capital Research Letter, supra note 34. Based on a survey of mutual funds, the fourth commenter stated that ongoing compliance with rule 498, as proposed, would require approximately 10 hours per fund per update. See ICI Letter, supra note 34. All three commenters, however, based their estimates on the proposal's requirement of quarterly updating of top 10 portfolio holdings and performance information. Because we are not requiring quarterly updating of performance information and we are not requiring any disclosure of top 10 portfolio holdings, we are not making further adjustments to our estimates.

378 (23 hours in the first year + 1.5 hours in the second year + 1.5 hours in the third year) ÷ 3 years = approximately 9 hours.

379 See Proposing Release, supra note 12, 72 FR at 67809. In the Proposing Release, we assumed that 75% of all funds would choose to send or give a Summary Prospectus. However, one commenter estimated that 80% of funds would elect to use the Summary Prospectus if the Commission eliminated quarterly updating requirements from the final rule. See ICI Letter, supra note 34. Having eliminated quarterly updating from the final rule and recognizing that the commenter had surveyed a major cross-section of the mutual fund industry, we have adopted the commenter's estimate that 80% of funds will likely choose to send or give a Summary Prospectus.

380 9 hours x 8,752 portfolios x .80.

C. ETF-Related Amendments

We are amending Form N-1A to provide more useful information to investors who purchase and sell ETF shares on national securities exchanges.

The amendments permit an ETF to exclude certain information from its prospectus that is not pertinent to investors purchasing individual ETF shares on secondary markets. Specifically, an ETF that has creation units of 25,000 shares or more may exclude from its prospectus: (i) information on how to purchase and redeem shares of the ETF;[381] and (ii) fee table fees and expenses for purchases and redemptions of creation units.[382] Based on conversations with industry representatives, Commission staff estimated in the ETF proposing release that these amendments would decrease the information collection burdens of an ETF that has creation units of 25,000 shares or more by an average of 1.4 hours per fund per filing of an initial registration statement or post-effective amendment to a registration statement. We requested comment on this estimate in the ETF proposing release. No commenters addressed this estimate and we continue to believe that it is appropriate.

The amendments also require disclosures designed to include important information for purchasers of individual ETF shares, as described below. An ETF will have to modify the narrative explanation preceding the example in the fee table in its prospectus and periodic reports to state that fund shares are sold on the secondary market rather than redeemed at the end of the periods indicated, and that investors in ETF shares may be required to pay brokerage commissions that are not reflected in the fee table.[383]

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381 Item 6(c)(2) of Form N-1A.

382 Instruction 1(e)(ii) to Item 3 of Form N-1A.

383 Instruction 1(e)(i) to Item 3 of Form N-1A; Instruction 1(e)(i) to Item 27(d) of Form N-

We believe that the added information collection burdens associated with this statement, if any, would be negligible.

The proposed amendments would have required each ETF to include a separate line item for returns based on the market price of ETF shares in the average annual total returns table in Item 2 of the Form,[384] and to calculate total return at market prices in addition to returns at NAV for their financial highlights tables.[385] At the suggestion of commenters, we have not adopted these requirements.

The proposed amendments would have required ETFs to include premium/discount information in both the prospectus and annual report of each ETF. Based on commenters suggestions, the final amendments permit ETFs to omit the historical premium/discount disclosure in those documents if the ETF includes premium/discount information on its Internet Web site and discloses in the prospectus and annual report an Internet address where investors can locate the information.[386] Commission staff estimated in the ETF proposing release that each ETF currently spends an average of 0.5 hours per filing of an initial registration statement or a post-effective

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1A. The amendments also require each ETF to identify the principal U.S. market on which its shares are traded and include a statement to the effect that ETF shares are bought and sold on national securities exchanges. We believe that the added information collection burdens associated with these very brief and specific statements, if any, would be negligible.

384 Proposed Instruction 5(a) to Item 2(c)(2) of Form N-1A.

385 Proposed Instruction 3(f) to Item 8(a) of Form N-1A.

386 Item 11(g)(2) of Form N-1A; Item 27(b)(7)(iv) of Form N-1A. Although the time period required in the disclosure is different in the prospectus and annual report, ETFs will be able to omit both disclosures by providing on their Internet Web site only the premium/discount information required by Item 11(g)(2) (the most recently completed fiscal year and quarters since that year). Id.

amendment to a registration statement to include this disclosure.[387] The staff further estimated that each ETF also would spend 0.5 hours per annual report to include this disclosure. We requested comment on these estimates in the ETF proposing release. No commenters addressed these estimates and we continue to believe that they are appropriate for ETFs that choose to include the information in the prospectus and annual report.

Based on Commission filings, Commission staff estimates that on an annual basis, ETFs file initial registration statements covering 98 ETF portfolios, and post-effective amendments covering 1,441 ETF portfolios on Form N-1A. Based on staff estimates, we estimate that the amendments will not increase the hour burden per ETF per filing on an initial registration or post-effective amendment to a registration statement. We estimate that the amendments will add approximately 0.5 hours, which staff estimates will be offset by a reduction of 1.4 hours (elimination of description of creation units and associated fees). Although the total annual hour burden for ETFs to prepare and file initial registration statements and post-effective amendments may decrease slightly, we are not decreasing our overall estimates to reflect the incremental decrease in order to be conservative in our estimates of the collection of information burdens.

V. COST/BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. We are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. The

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[387] This estimate is based on discussions with representatives of ETFs, which include premium/discount information as required by their exemptive orders.

key information is required to be presented in plain English in a standardized order. Our intent is that this information will be presented succinctly, in three or four pages, at the front of the prospectus.

We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus will be provided on an Internet Web site. Upon an investor's request, funds will also be required to send the statutory prospectus to the investor. Our intent in providing this option is that funds take full advantage of the Internet's search and retrieval capabilities in order to enhance the provision of information to mutual fund investors.

The disclosure framework that we are adopting has the potential to revolutionize the provision of information to the millions of investors who rely on mutual funds for their most basic financial needs. It is intended to help investors who are overwhelmed by the choices among thousands of available funds described in lengthy and legalistic documents to readily access key information that is important to an informed investment decision. At the same time, by harnessing the power of technology to deliver information in better, more useable formats, the disclosure framework can help those investors, their intermediaries, third-party analysts, the financial press, and others to locate and compare facts and data from the wealth of more detailed disclosures that are available.

In the proposing release, we requested public comment and specific data regarding the costs and benefits of the amendments. As discussed below, we received five comments directly addressing our quantitative cost/benefit analysis.[388] We also received numerous comments pertinent to qualitative aspects of our analysis.[389]

A. Benefits

1. Form N-1A

Possible benefits of the amendments include enhanced disclosure of information needed to make informed investment decisions about mutual funds, more rapid dissemination of information over the Internet, and reduced printing and mailing costs.

Millions of individual Americans invest in shares of mutual funds, relying on mutual funds for their retirements, their children's educations, and their other basic financial needs.[390] These investors face a difficult task in choosing among the more than 8,000 available mutual funds.[391] Fund prospectuses, which have been criticized by investor advocates, representatives of the fund industry, and others as long and complicated, often prove difficult for investors to use efficiently in comparing their many choices. Current Commission rules require mutual fund prospectuses to contain key information about investment objectives, risks, and expenses that, while important to investors, can be difficult for investors to extract. Prospectuses are often long, both because they contain a wealth of detailed information and because prospectuses for

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388 See Data Communiqué Letter, supra note 35; ICI Letter, supra note 34; MFS Letter, supra note 150; NewRiver Letter, supra note 228; Memorandum from the Division of Investment Management regarding August 25, 2008 meeting with representatives of RR Donnelly & Sons Co. and Prospectus Central, LLC (Aug. 26, 2008) ("RR Donnelley Memorandum").

389 See, e.g., AARP Letter, supra note 34; CFA Institute Letter, supra note 37; CMFI Letter, supra note 44; Fund Democracy et al. Letter, supra note 34; ICI Letter, supra note 34; MFDF Letter, supra note 34; NAPFA Letter, supra note 44.

390 See supra note 16.

391 See 2008 ICI Fact Book, supra note 16, at 15.

multiple funds are often combined in a single document. Too frequently, the language of prospectuses is complex and legalistic, and the presentation formats make little use of graphic design techniques that would contribute to readability.

The amendments require investment information that is key to an investment decision to be provided in a streamlined document with other more detailed information provided elsewhere. The provision of this information to investors in concise, user-friendly formats will allow investors to compare information across funds and may assist them in making better informed portfolio allocation decisions in line with their investment goals.

The amendments also will provide the additional benefits of increased Internet availability of fund information, by providing layered disclosure that allows investors to move back and forth between the information within the Summary Prospectus and more detailed information within other disclosure documents. These benefits include, among other things, facilitating comparisons among funds and replacing one-size-fits-all disclosure with disclosure that each investor can tailor to his or her own needs. In recent years, access to the Internet has greatly expanded,[392] and significant strides have been made in the speed and quality of Internet connections.[393] Advances in technology offer a promising means to address the length and complexity of mutual fund prospectuses by streamlining the key information that is provided to investors, ensuring that access to the full wealth of information about a fund is immediately and easily accessible, and providing the means to present all information about a fund online in a format that facilitates comparisons of key information, such as expenses, across different funds and

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392 See supra note 25.

393 See supra note 26.

different share classes of the same fund. Technology has the potential to replace the current one-size-fits-all mutual fund prospectus with an approach that allows investors, their financial intermediaries, third-party analysts, and others to tailor the wealth of available information to their particular needs and circumstances.

Significant technological advances have increased both the market's demand for more timely disclosure and the ability of funds to capture, process, and disseminate information. The amendments will enable funds to take greater advantage of the Internet to more rapidly communicate and deliver information to investors. Accordingly, investor demand for information could be satisfied through relatively inexpensive mass dissemination of the information through electronic means. We anticipate that demand for the information in the statutory prospectus and SAI will increase as access to that information becomes easier through the use of layered disclosure that allows investors, their financial intermediaries, third-party analysts, and others to tailor the wealth of available information to their particular needs and circumstances.

Nearly all of the comments we received, including comments from consumer groups and industry representatives, agreed with our conclusion that investors will benefit greatly from receiving the Summary Prospectus containing key information that investors will be more likely to read and understand, with the ability to access more detailed information either immediately in a user-friendly format online or, within a matter of days, in paper.[394] This conclusion is also supported by our recent telephone survey of investors, which found that many mutual fund investors do not read statutory

394 See, e.g., Fund Democracy et al. Letter, supra note 34; ICI Letter, supra note 34; see also supra notes 315-317 and accompanying text (discussing the qualitative benefits of the amendments).

prospectuses because they are long, complicated, and hard to understand.[395] In addition, the views expressed by investors in our focus groups also support our conclusion that investors will derive significant benefits from the Summary Prospectus, coupled with ready access to more detailed information in whatever format they choose.[396]

In addition to benefiting investors, the Summary Prospectus also will provide quantifiable cost savings to funds. We believe that funds will benefit from being able to send or give a Summary Prospectus rather than having to print and send statutory prospectuses to all investors and prospective investors. We expect that funds will experience cost savings with respect to both annual mailings to their current shareholders and mailings made in connection with a purchase of fund shares. We estimate that funds distribute approximately 300,000,000 statutory prospectuses annually to their current shareholders[397] and another 64,500,000 in connection with fund purchases.[398] We

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395 Telephone Survey Report, supra note 32, at 56, 58.

396 See Focus Group Report, supra note 32, at 5-6. See also Focus Group Transcripts, supra note 32, at 63 ("It's a two-minute read. If I want more information, I can ask for it."); id. at 38 ("I think both [the long-form prospectus and short-form prospectus] have their place. I think it would be foolish to give up the long-form for 'this' and I think it would be foolish not to have the short-form and insist on a long-form. They both have their place.").

397 See 2008 ICI Fact Book, supra note 16, at 110 (estimating 298,966,000 shareholder accounts at the end of 2007). In the Proposing Release, we used an estimate of 290,000,000 statutory prospectuses, which was based on the 2007 version of the ICI Fact Book estimate of the number of shareholder accounts at the end of 2006. See Proposing Release, supra note 12, 72 FR at 67810.

Often, a fund will mail a statutory prospectus to each of its shareholders annually in addition to mailing a statutory prospectus in connection with a purchase of fund shares. We recognize that: some shareholders may currently receive their fund documents electronically; some households where more than one fund investor resides will only receive one copy of the statutory prospectus per household; some accounts may hold more than one fund; and not all funds send out statutory prospectuses annually. Therefore, the actual number of prospectuses mailed annually may be higher or lower than our estimate.

received two comments related to the estimated number of statutory prospectuses that are distributed.[399]

We estimate that the cost savings for annual mailings will be approximately $126,000,000[400] and that the cost savings for purchase mailings will be approximately $80,496,000.[401] These cost savings would be reduced by the costs of sending the

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398 Our estimate of the number of statutory prospectuses sent out to fulfill a fund's prospectus delivery obligation upon purchase is based on information provided by Broadridge Financial Solutions, Inc. ("Broadridge") prior to issuing the Proposing Release. See Memorandum from the Division of Investment Management regarding October 25, 2007 meeting with Broadridge representatives (Nov. 28, 2007) ("Broadridge Memorandum").

399 One commenter stated that our estimates of the numbers of statutory prospectuses distributed to existing shareholders and investors purchasing shares in the Proposing Release are reasonable because they fall within the range between the commenter's lowest possible estimates (230,000,000 for annual fulfillment and 58,000,000 for purchase fulfillment) and the commenter's highest possible estimates (373,000,000 million for annual fulfillment and 95,000,000 for purchase fulfillment). See ICI Letter, supra note 34. A second commenter estimated that the number of statutory prospectuses distributed to existing shareholders is 231,981,600 and the number distributed to investors purchasing fund shares is 72,494,250, based on its experience preparing distributions of statutory prospectuses and shareholder reports for mutual funds. See Data Communiqué Letter, supra note 35.

400 Our annual estimates are derived from information we received from Broadridge. See Broadridge Memorandum, supra note 398. Broadridge estimated that the average cost of a statutory prospectus printed in a full production run is $0.27 and that the average cost to mail a statutory prospectus by bulk mail is $0.255. Id. The cost savings with respect to annual mailings were calculated by multiplying the costs of printing and mailing a statutory prospectus by the 300,000,000 statutory prospectuses mailed annually reduced to reflect our estimate that 80% of funds will elect to send Summary Prospectuses (($0.27 for the printing of a statutory prospectus + $0.255 for the mailing of a statutory prospectus) x 300,000,000 statutory prospectuses x 80% of funds).

401 For purposes of our estimate, we used Broadridge's printing cost estimate of $0.35 that is blended to reflect full production printing runs and digital print on demand documents. Id. This blended rate reflects the fact that a fund may run out of statutory prospectuses produced in a full production run and may have to print additional statutory prospectuses on demand. Broadridge also estimated that the average cost to mail a statutory prospectus by first class mail is $1.21. Id. The cost savings with respect to purchase mailings were calculated by multiplying the costs of printing and mailing a statutory prospectus by 64,500,000 statutory prospectuses mailed in connection with a fund purchase reduced to reflect our estimate that 80% of funds will elect to send Summary Prospectuses (($0.35 for the printing of a statutory prospectus + $1.21 for the mailing of a statutory prospectus) x 64,500,000 statutory prospectuses x 80% of funds).

statutory prospectus to those investors who request it. We estimate that approximately 2% of the investors who own shares in the 80% of funds that likely will choose to send or give the Summary Prospectus will request that a statutory prospectus be mailed to them.[402] We estimate that the cost of mailing statutory prospectuses to existing investors would be $12,288,000.[403] We further estimate that approximately 3% investors purchasing shares in the 80% of funds that likely will choose to send or give the Summary Prospectus will request that a statutory prospectus be sent to them.[404] We

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402 We originally did not project that existing investors would request hard copies of the statutory prospectus. However, one commenter stated that at most 2% of existing investors would likely request hard copies, based on information from Broadridge indicating investor requests for written materials under the Commission's notice and access e-proxy model have averaged around 2%. See ICI Letter, supra note 34. We believe that it is reasonable to estimate a similar percentage of existing investors will request hard copies of the statutory prospectus.

403 For purposes of this estimate, we used the digital print on demand rate of $1.35 and the average first class mail rate of $1.21. See Broadridge Memorandum, supra note 398 (estimating postage costs of $1.21); ICI Letter, supra note 34 (estimating a digital print on demand rate of $1.35). In the Proposing Release, we estimated a blended print rate of $0.35 for prospectuses sent to requesting investors. See Proposing Release, supra note 12, 72 FR at 67810 n. 162. However, one commenter stated that this estimate is too low because it largely reflects economies of scale from high volume offset printing that are not realistic given the likely low number of investor requests for hard copies of the statutory prospectus. See ICI Letter, supra note 34. Therefore, we have adopted the commenter's digital print rate estimate of $1.35.

The costs were calculated by multiplying the costs of printing and mailing a statutory prospectus by the 300,000,000 prospectuses sent out annually to existing shareholders reduced to reflect our estimate that 80% of funds will elect to adopt the new disclosure option and 2% of investors will request a statutory prospectus be mailed to them (($1.35 for the printing of a statutory prospectus + $1.21 for the mailing of a statutory prospectus) x 300,000,000 statutory prospectuses x 80% of funds x 2% of investors).

404 In the Proposing Release, we originally estimated that 10% of such investors would likely request hard copies of the statutory prospectus. However, one commenter stated that 2% of both existing investors and investors purchasing fund shares would request hard copies of the statutory prospectus. See ICI Letter, supra note 34. While we agree with the commenter that we may have initially underestimated the percentage of existing investors and overestimated the percentage of purchasing investors that would request hard copies, we do not believe that the same percentage of both groups would request hard copies. Investors making initial fund purchases would potentially have a greater interest in receiving hard copies of statutory prospectuses than investors that have owned fund

estimate that the cost of sending statutory prospectuses requested by investors making purchases of fund shares would be approximately $3,962,880.[405] Therefore, we estimate the annual cost savings will be approximately $190,245,120,[406] or approximately $21,737 per portfolio.[407]

We received four comments bearing on the cost savings of the new delivery option.[408] Of those, only two commenters provided actual estimates of the total savings

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shares for some time. For this reason, we have lowered our original estimate that 10% of investors purchasing fund shares would request hard copies, but have lowered it less than the commenter suggested.

405 For purposes of this estimate, we used the digital print on demand rate of $1.35 and the average first class mail rate of $1.21. See supra note 403. The costs were calculated by multiplying the costs of printing and mailing a statutory prospectus by the 64,500,000 prospectuses sent out in response to fund purchases reduced to reflect our estimate that 80% of funds will elect to send Summary Prospectuses and 3% of investors will request a statutory prospectus be mailed to them (($1.35 for the printing of a statutory prospectus + $1.21 for the mailing of a statutory prospectus) x 64,500,000 statutory prospectuses x 80% of funds x 3% of investors).

406 ($126,000,000 cost savings for annual mailings + $80,496,000 cost savings for purchase mailings) – ($12,288,000 cost of sending requested statutory prospectuses to existing investors + $3,962,880 cost of sending requested statutory prospectuses to investors purchasing funds).

A study of industry participants estimated cost savings of approximately $300,000,000 per year. See Forrester Consulting Study commissioned on behalf of NewRiver, Inc., The Short-Form Prospectus, at 6 (Oct. 2007), available at http://www1.newriver.com/upload_files/ForresterConsulting_NewRiver_ShortForm_Prospectus_10_25_2007.pdf.

407 $190,245,120 ÷ 8,752 portfolios.

Although we believe that not all funds will choose to use the Summary Prospectus, we believe it is appropriate to estimate the amendments' effect across the entire mutual fund industry. Therefore, we have estimated the average cost savings per portfolio industry-wide rather than estimate the cost savings per portfolio only for those portfolios using the Summary Prospectus.

408 See Data Communiqué Letter, supra note 35; ICI letter, supra note 34; MFS Letter, supra note 150; RR Donnelley Memorandum, supra note 388.

that would be generated by the new delivery option.[409] Insofar as these two commenters' total savings estimates differed from our $190,245,120 figure, they did so largely because the commenters assumed different per unit printing and postage costs. However, assuming (1) that 80% of funds will choose to send or give the Summary Prospectus, (2) that funds distribute approximately 300,000,000 statutory prospectuses to existing investors annually and distribute approximately 64,500,000 statutory prospectuses to purchasing investors annually, and (3) that 2% of existing investors in funds using the new delivery option and 3% of investors purchasing shares in such funds request hard copies of the statutory prospectus, the commenters' differing per unit printing and postage cost estimates would not produce total cost savings estimates that differ significantly from our estimate.[410]

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409 See Data Communiqué Letter, supra note 35 (estimating $220,254,203 in annual cost savings) ICI Letter, supra note 34 (estimating $236,000,000 in annual cost savings).

The two commenters also provided the printing and postage cost estimates they used to arrive at their total cost savings estimates. See Data Communiqué Letter, supra note 35 (estimating per unit printing and postage costs for annual fulfillment of $0.25 and $0.392 respectively, per unit printing and postage costs for purchase fulfillment of $0.25 and $0.654 respectively, and a blended per unit printing and postage cost for delivery of hard copies of the statutory prospectus to requesting investors of $0.50); ICI Letter, supra note 34 (estimating per unit printing and postage costs for annual fulfillment of $0.26 and $0.255 respectively, per unit printing and postage costs for purchase fulfillment of $0.26 and $1.39 respectively, and per unit printing and postage costs for delivery of hard copies of the statutory prospectus to requesting investors of $1.35 and $1.39 respectively).

Of the two commenters that did not provide total cost savings estimates, one commenter estimated that it currently pays an average of $0.15 per piece for offset printing of a statutory prospectus. MFS Letter, supra note 150. The other commenter estimated that a fund with a print volume of 30,000 64-page statutory prospectuses could save 6.3% by using a four-page Summary Prospectus and that a fund with a print volume of 100,000 64-page statutory prospectuses could save 22.2%, assuming that 10% of investors still request hard copies of the statutory prospectus. RR Donnelley Memorandum, supra note 388.

410 One commenter also did not account for the fact that less than 100% of funds would adopt the new delivery option in its calculation of quantified benefits. See ICI Letter, supra note 34.

We expect that funds will face the highest level of uncertainty about the extent of investors' continued use of printed statutory prospectuses in the first year after adoption of the amendments. We expect that, as funds gain familiarity with the extent of continued use of printed prospectuses and as shareholders increasingly turn to the Internet for fund information, the number of requested paper copies will decline, as will funds' tendency to print more copies than ultimately are requested.

2. ETF-Related Disclosures

As noted above, in March of this year, the Commission proposed several amendments to Form N-1A to accommodate the use of the form by ETFs, and we are adopting those amendments today, with some changes to respond to issues raised by commenters. As noted in the ETF proposing release, many of the exemptive orders that permit an ETF to operate exempt broker-dealers from the obligation to deliver prospectuses in secondary market transactions. The exemptive orders permit a broker-dealer instead to deliver a product description containing basic information about the ETF and its shares. We understand that many, if not most, broker-dealers transmit a prospectus to purchasers and do not rely on the exemption in our orders. In light of this practice, we are adopting amendments to Form N-1A designed to meet the needs of investors (including retail investors) who purchase ETF shares in the secondary market rather than financial institutions that purchase creation units directly from the ETF.

We expect that one benefit of the amendments will be to provide ETF investors purchasing shares in the secondary market with information on the investment that they currently may not receive in a product description, such as the fund's fee table and the name and length of service of the portfolio manager. Another benefit of the amendments will be to provide ETF investors purchasing shares in the secondary market with prospectus disclosure that is specifically tailored to ETFs. We expect this would provide ETF investors with information that will allow them to understand more easily an investment in an ETF. This information also may be helpful to investors in making portfolio allocation decisions.

Our amendments are designed to simplify prospectus and periodic report disclosure in two ways. First, the amendments allow ETFs to exclude from the prospectus information on how to purchase and redeem creation units, including information on fees and expenses associated with creation unit sales or purchases. Current ETF prospectuses and periodic reports include detailed information on how to purchase and redeem creation units. The fee table and example include information on transaction fees payable only by creation unit purchasers. Our amendments permit ETFs with creation units of at least 25,000 shares to exclude this information because it is not relevant (and may be potentially confusing) to investors purchasing in secondary market transactions.[411] This provision should simplify ETF prospectuses without compromising the disclosure provided to investors who purchase ETF shares in secondary market transactions.

Second, our exemptive orders require ETFs to include in their prospectuses and annual reports premium/discount information to alert investors of the extent and frequency with which market prices deviated from the fund's NAV. ETFs may omit this disclosure if they provide the information on their Internet Web sites and provide an Internet address where investors may locate the information. ETFs have generally included this information in a supplemental section of the prospectus and annual

411 See supra Part III.A.4.

report.[412] The amendments incorporate this disclosure in the shareholder information section (Item 11 of Form N-1A) of the prospectus and the management's discussion of fund performance in the annual reports (Item 27(b)(7) of Form N-1A). We anticipate that this may benefit ETF investors by simplifying the prospectuses and annual reports of ETFs while codifying important disclosures mandated by our ETF exemptive orders. ETFs also may benefit because they may choose to disclose this information in the most cost efficient way – either in the prospectus and the annual report, or on their Web sites.

B. Costs

1. Form N-1A

While the amendments will result in significant cost savings for funds, we believe that there will be costs associated with them. These include the costs for funds to compile and review the new information required by our amendments and to post the required disclosure documents on an Internet Web site. These costs may include both internal costs (for attorneys and other non-legal staff, such as computer programmers, to prepare and review the required disclosure) and external costs (for printing and mailing of the Summary Prospectus). We estimate that the external costs for printing and mailing of the Summary Prospectus will be approximately $106,200,000[413] or approximately $12,134 per portfolio.[414]

412 See, e.g., iShares MSCI Series, Prospectus 62-65 (Jan. 1, 2007); iShares MSCI Series, 2006 Shareholders Annual Report 130-136 (Aug. 31, 2006).

413 This estimate assumes printing and postage costs for annual fulfillment of $0.08 and $0.255 per unit respectively and printing and postage costs for purchase fulfillment of $0.08 and $0.42 per unit respectively. We increased our estimate of postage costs for purchase fulfillment from $0.41 in the Proposing Release to $0.42 to reflect the current rate for first class mail. Our estimate is derived as follows: [(($0.08 to offset print a Summary Prospectus + $0.255 for bulk mail) x 300,000,000 prospectuses estimated to be sent out annually) + (($0.08 to offset print a Summary Prospectus + $0.42 for first class mail) x 64,500,000 prospectuses estimated to be sent out in response to a fund purchase)] x 80% of funds.

We received four comments regarding our estimates of per unit print costs for the Summary Prospectus.[415] Of the four commenters, only one accounted for the likelihood that some funds would print Summary Prospectuses in color.[416] In discussing its estimates, the commenter reported that 47% of funds it surveyed expected to use color for the Summary Prospectus. Therefore the commenter's per unit print cost estimates

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In the Proposing Release, we estimated printing costs of $0.11 per unit for on-demand printing in black and white. See Proposing Release, supra note 12, 72 FR at 67811 n. 168. However, we have changed our estimate of per unit printing costs based on comments we received and based on our decision not to include a quarterly updating requirement in the final rule. Instead of using the original $0.11 per unit figure for on-demand printing in black and white, we now estimate printing costs of $0.08 per unit, a figure representing offset printing of a blend of color and black and white. See ICI Letter, supra note 34.

414 $106,200,000 ÷ 8,752 portfolios.

Our new cost/benefit analysis retains our original postage costs of $0.255 per unit for annual fulfillment and $0.41 per unit for purchase fulfillment. Two commenters assumed the same postage costs in their cost/benefit analyses. See ICI Letter, supra note 34; NewRiver Letter, supra note 228. Another commenter's estimates of postage costs were close to ours ($0.233 per unit for annual fulfillment and $0.484 per unit for purchase fulfillment). See Data Communiqué Letter, supra note 35. By contrast, a fourth commenter estimated postage costs of $0.241 per Summary Prospectus, without differentiating between annual and purchase fulfillment costs. See RR Donnelley Memorandum, supra note 388. However, we did not adjust our postage cost estimates based on this comment because the other three commenters largely agreed with our original postage cost estimates.

Although we believe that not all funds will choose to use the Summary Prospectus, we believe it is appropriate to estimate the amendments' effect across the entire mutual fund industry. Therefore, we have estimated the average external costs per portfolio industry-wide rather than estimate the costs per portfolio only for those portfolios using the Summary Prospectus.

415 Data Communiqué Letter, supra note 35 (estimating $0.07 per unit for offset printing in black and white); ICI Letter, supra note 34 (estimating $0.17 per unit for annual fulfillment and $0.26 per unit for purchase fulfillment, with both figures representing a blend of offset printing and print on demand as well as a blend of color and black and white printing); MFS Letter, supra note 150 (estimating $0.10 per unit for print on demand, but not indicating whether that figure includes any color printing); NewRiver Letter, supra note 228 (estimating $0.10 per unit for print on demand, but not indicating whether that figure includes any color printing).

416 See ICI Letter, supra note 34.

represent a blend of 47% color and 53% black and white. Assuming that the Commission would require quarterly updating of the Summary Prospectus, the commenter estimated a per unit printing cost of $0.17 for annual fulfillment and $0.26 for purchase fulfillment.[417] However, the commenter also estimated that without quarterly updating, most funds would print Summary Prospectuses by offset methods, and therefore estimated a per unit print cost of $0.08 per unit for both annual and purchase fulfillment.[418]

We accept the commenter's assertion that roughly half of funds will print their Summary Prospectuses in color and half will print in black and white because their estimate was based on a survey of a broad cross-section of the mutual fund industry. Additionally, with the elimination of quarterly updating requirements in the final rule, we believe that most funds will likely print Summary Prospectuses for annual and purchase fulfillment at the same time, giving most funds sufficient print volume to make offset printing methods economical.[419] Therefore, we have revised our estimates of per unit print costs for annual and purchase fulfillment to $0.08 per unit.

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417 Given our assumptions that 80% of funds will adopt the Summary Prospectus, that funds distribute 300 million prospectuses for purposes of annual fulfillment, and that they distribute 64.5 million prospectuses for purchase fulfillment each year, the commenter's per unit postage and mailing cost estimates would lead to total postage and mailing costs of $136,572,000 annually [(($0.17 for a blend of offset/print on demand and color/black and white printing + $0.255 for bulk mail) x 300,000,000 prospectuses estimated to be sent out annually) + (($0.26 for print on demand of a blend of color/black and white printing + $0.41 for first class mail) x 64,500,000 prospectuses estimated to be sent out in response to a fund purchase)] x 80% of funds.

418 See Memorandum from the Division of Investment Management regarding September 29, 2008 telephone conversation with representatives of the Investment Company Institute (October 6, 2008).

419 We recognize that some funds may not have sufficient numbers of investors and purchasers to warrant printing Summary Prospectuses by offset method. ICI, however, estimated that absent a quarterly updating requirement, nearly 90% of funds would print Summary Prospectuses by offset methods. See id.

For purposes of the PRA, we have estimated that the new disclosure requirements, assuming 80% of funds choose to send or give a Summary Prospectus, would add: (1) 70,016 hours to the annual burden of preparing Form N-1A; and (2) 63,014 hours to the annual burden of preparing and using a Summary Prospectus, including complying with Internet posting requirements, under rule 498. We estimate that this additional burden would equal total internal costs of $37,248,400 annually[420] or approximately $4,256 per portfolio.[421]

The amendments also may result in costs associated with investors printing fund documents posted online. We estimate that approximately ½% of existing investors and 3% of investors purchasing shares will print statutory prospectuses at an estimated cost of $2.03 per statutory prospectus.[422] Based on these assumptions, the amendments are estimated to produce annual investor printing costs of $5,578,440.[423]

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420 This cost increase is estimated by multiplying the total annual hour burden (133,030 hours) by the rounded estimated hourly wage rate of $280. The estimated wage figure is based on published rates for compliance attorneys and senior programmers, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding effective hourly rates of $270 and $289, respectively. See Securities Industry and Financial Markets Association's Report on Management & Professional Earnings in the Securities Industry 2007. The estimated wage rate is further based on the estimate that attorneys and programmers would divide time equally, resulting in a rounded weighted wage rate of $280 (($270 x .50) + ($289 x .50)).

In the Proposing Release, we estimated an hourly wage rate of $252.50, which was based on the Report on Management & Professional Earnings in the Securities Industry 2006. See Proposing Release, supra note 12, 72 FR at 67811 n. 170.

421 $37,248,400 ÷ 8,752 portfolios.

In the Proposing Release, we estimated the costs per fund choosing to use the Summary Prospectus. See Proposing Release, supra note 12, 72 FR 67811 n. 166. We have revised this calculation to produce an average cost per portfolio industry-wide.

422 Our estimate of potential printing costs is based on data provided by Lexecon Inc. in response to Investment Company Act Release No. 27182 (Dec. 8, 2005) [70 FR 74598 (Dec. 15, 2005)]. See Lexecon Inc. Letter (Feb. 13, 2006). To calculate printing costs,

We received one comment letter arguing that the use of the Summary Prospectus under rule 498 may impose costs on investors by relieving funds of liability for misleading disclosure.[424] For the reasons discussed in Parts III.B.4.a. and III.B.5., we do not believe that the amendments, as adopted, will entail such costs.

2. ETF-Related Disclosures

The primary goal of our amendments relating to ETF disclosures is to provide investors in ETF shares with more valuable information regarding an investment in an ETF. We do not expect that the amendments will result in significant additional costs to ETFs.[425] As noted above, the N-1A amendments generally codify disclosure requirements in existing ETF exemptive orders.

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we estimate that 100% of prospectuses are printed in black and white at a cost of \$0.035 per page for ink and that the average prospectus length is approximately 45 pages at a cost of \$0.010 per page for the paper ((\$0.035 for ink + \$0.010 for paper) x 45 pages).

In the Proposing Release, we estimated that approximately 5% of investors making fund purchases would print statutory prospectuses. See Proposing Release, supra note 12, 72 FR at 67811. However, we received a comment estimating that 2% of both existing investors and investors purchasing fund shares would print the statutory prospectus. See ICI Letter, supra note 34. While we agree with the commenter that we may have initially underestimated the percentage of existing investors and overestimated the percentage of investors purchasing fund shares that would print the statutory prospectus, we do not believe that the same percentage of both groups of investors would print statutory prospectuses. Rather, we believe that investors making initial fund purchases would have greater interest in printing statutory prospectuses than investors who already own fund shares. Thus, we have lowered our original estimate of investors purchasing shares who print the statutory prospectus to 3% and estimate that approximately ½% of existing investors will print statutory prospectuses.

423 (300,000,000 x ½% of printing investors) + (64,500,000 x 3% of printing investors) x 80% of funds x \$2.03.

424 Fund Democracy et al. Letter, supra note 34.

425 Existing ETFs would face a one-time "learning cost" to determine the difference between the current Form N-1A requirements as modified by their exemptive orders and the amendments we are adopting today. We do not anticipate that this cost will be significant given the similarity of the amendments to the conditions in existing exemptive orders.

In addition to codifying disclosure requirements of existing exemptive orders, we are adopting a few new disclosure requirements in Form N-1A. The disclosure amendments require each ETF to identify the principal U.S. market on which its shares are traded[426] and include statements to the effect that (i) ETF shares are bought and sold on national securities exchanges;[427] (ii) because the price of shares is based on market price, shares may trade at a premium or discount to NAV;[428] and (iii) ETF investors may be required to pay brokerage commissions.[429] Including these additional statements should present minimal, if any, printing costs. Any additional costs incurred by an ETF in complying with these additional disclosures should be offset by the cost-savings of the amendments, which would allow most, if not all, ETFs to exclude creation unit purchase and redemption information in their prospectuses.[430]

VI. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 2(c) of the Investment Company Act[431] and Section 2(b) of the Securities Act[432] require the Commission, when engaging in rulemaking that requires it to consider

426 Item 1(a)(2) of Form N-1A.; rule 498(b)(1)(ii).

427 Item 6(c)(i)(A) of Form N-1A.

428 Item 6(c)(i)(B) of Form N-1A.

429 Instruction 1(e)(i) to Item 3 of Form N-1A. We also are adopting a conforming amendment to the expense example in ETF annual and semi-annual reports. Instruction 1(e)(i) to Item 27(d) of Form N-1A.

430 See Instruction 1(e)(ii) to Item 3 of Form N-1A; Items 6(c)(ii); 11(g)(1) of Form N-1A. For purposes of our Paperwork Reduction Act analysis, we have estimated that these amendments will not change the current Form N-1A compliance costs. See supra Part IV.C.

431 15 U.S.C. 80a-2(c).

432 15 U.S.C. 77b(b).

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 requested, but did not receive, any comments directly addressing whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation, or comments on any anti-competitive effects of the proposed amendments.[433]

The amendments we are adopting are intended to provide enhanced disclosure regarding mutual funds. These changes may improve efficiency. The enhanced disclosure requirements may enable shareholders to make more informed investment decisions by focusing attention on key information, which could promote efficiency. We anticipate that the amendments will increase efficiency at mutual funds by providing an alternative to the printing and mailing of paper copies of statutory prospectuses.

We anticipate that improving investors' ability to make informed investment decisions may also lead to increased competitiveness of the U.S. capital markets. The ability of investors to directly locate the information they seek regarding a fund or funds through the use of the Internet may result in more investment in the U.S. capital markets. In addition, we believe that the amendments may enhance competition and efficiency because they will reduce fund printing and mailing costs. Funds could, for example, use these savings to conduct additional investment research or to pass cost savings on to investors. We also believe that the amendments will enhance competition among funds because they will facilitate investor comparisons of mutual fund information, including important cost and fee disclosures.

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433 See Proposing Release, supra note 12, 72 FR at 67812.

We anticipate that this increased market efficiency also may promote capital formation by improving the flow of information between funds and their investors. Specifically, we believe that the amendments will: (1) facilitate greater availability of information to investors and the market with regard to all funds; (2) build upon the increased importance of electronic dissemination of information, including the use of the Internet; and (3) promote the capital formation process.

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.[434] It relates to the Commission's amendments to Form N-1A under the Securities Act and the Investment Company Act and to new rule 498 under the Securities Act.

A. Need for the Rule

We are adopting an improved mutual fund disclosure framework that is intended to provide investors with information that is easier to use and more readily accessible, while retaining the comprehensive quality of the information that is available today. The foundation of the improved disclosure framework is the provision to all investors of streamlined and user-friendly information that is key to an investment decision.

In addition, the amendments to Form N-1A that specifically apply to ETFs are intended to accommodate the form for use by ETFs and are designed to provide more useful information to investors who purchase and sell ETF shares on national securities exchanges.

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434 5 U.S.C. 603 <u>et seq</u>.

B. Significant Issues Raised by Public Comment

In the proposing release, we requested comment on the number of small entity issuers that may be affected, the existence or nature of the potential impact and how to quantify the impact of the amendments. Commenters generally supported the proposal.[435] One commenter, however, stated that the proposal would simply add another costly burden to small fund families.[436] While we believe there will be some costs associated with the amendments, we have tried to minimize those costs. Nearly all of the information that is required in the summary section of the prospectus under the amendments has previously been required in a fund's prospectus. We eliminated the proposed quarterly updating requirement in response to commenters' concerns. In addition, we have made use of the Summary Prospectus voluntary, meaning that a fund can choose whether or not to adopt it considering its costs and benefits to the fund and its investors.

In the initial regulatory flexibility analysis for the ETF proposing release, we requested comment on any aspect of the IRFA, including the number of small entities likely to rely on the proposed amendments to Form N-1A, the likely impact of the proposed amendments on small entities, and the nature of any impact on small entities. We also requested empirical data supporting the extent of any impact on small entities. We received no comments on that analysis.

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435 See supra note 206 and accompanying text.

436 See McCormick Letter, supra note 74. The commenter made specific suggestions for improving mutual fund disclosure, such as consolidating the statutory prospectus and SAI and eliminating the semi-annual reports and quarterly filings on Form N-Q, that were beyond the scope of this particular rulemaking.

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.[437] Approximately 127 mutual funds registered on Form N-1A meet this definition.[438] Of the approximately 593 registered open-end investment companies that are ETFs, only one is a small entity.[439]

D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments we are adopting require all funds, including funds that are small entities, to provide key information in a summary section of their statutory prospectuses. In addition, the amendments provide a new option that will permit a person to satisfy its mutual fund prospectus delivery obligations under the Securities Act. Under the option, key information will be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus will be provided on an Internet Web site. Upon an investor's request, funds are required to send the statutory prospectus to the investor. No funds are required to send or give a Summary Prospectus. However, for purposes of the PRA, we estimate that 80% of all funds will choose to send or give a Summary Prospectus pursuant to rule 498 both to enhance investor access to information about a fund and to

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437 17 CFR 270.0-10.

438 This estimate is based on analysis by the Division of Investment Management staff of publicly available data.

439 For purposes of this analysis, any series or portfolio of an ETF is considered a separate ETF. Therefore, there are 593 portfolios or series of registered open-end investment companies operating as ETFs. For purposes of determining whether a fund is a small entity under the Regulatory Flexibility Act, however, the assets of funds (including each portfolio and series of a fund) in the same group of related investment companies are aggregated.

take advantage of the cost savings that a fund may realize. If a fund elects the new delivery regime for prospectuses, it is required to prepare, file, and send or give a Summary Prospectus to investors. The required disclosure in the Summary Prospectus is information that generally is readily available to funds. A fund is required to post the statutory prospectus along with other required documents to an Internet Web site and provide either a paper or an e-mail copy of its statutory prospectus to requesting shareholders.

For purposes of the Paperwork Reduction Act, we have estimated that the new disclosure requirements would increase the hour burden of filings on Form N-1A by 70,016 hours annually and for rule 498 by 63,014 hours annually. We estimate that this additional burden would increase total internal costs per portfolio, including those that are small entities, by approximately $4,256 per portfolio annually.[440] We also estimate that the external costs for printing and mailing of the Summary Prospectus will be approximately $12,075 per portfolio.[441] However, we estimate that the benefit of decreased printing and other costs will decrease total external costs per portfolio, including those that are small entities, by approximately $21,737 per portfolio annually.[442]

The amendments to Form N-1A that specifically apply to ETFs will impose reporting requirements on open-end funds that operate as ETFs. The amendments require

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440 These figures are based on an estimated hourly wage rate of $280. See supra note 420. We note that this estimate includes a one-time burden of 17 hours to create the summary section of the statutory prospectus and a one-time burden of 23 hours to create the Summary Prospectus.

441 See supra note 414 and accompanying text.

442 See supra note 407 and accompanying text.

an ETF to disclose in its prospectus and annual reports the number of trading days on which the market price of an ETF's shares was greater than its NAV and the number of days it was less than its NAV (premium/discount information) unless the ETF discloses this information on its Web site and provides an Internet address where an investor can locate the information.[443] The amendments also require the ETF to disclose in its prospectus (in addition to its exchange ticker trading symbol), the principal U.S. market(s) on which its shares are traded.[444]

The amendments to Form N-1A also eliminate some disclosure requirements for ETFs with creation units of 25,000 or more shares and replace them with fewer disclosures. Under the amendments, those ETFs do not have to: (i) disclose information on how to buy and redeem shares of ETF;[445] (ii) include in its fee table in its prospectus or annual and semi-annual reports fees and expenses for purchases or sales of creation units;[446] or (iii) disclose procedures for the purchase and redemption of fund shares.[447]

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443 Item 11(g)(2) of Form N-1A (requiring premium/discount information in the prospectus to span the most recently completed calendar year and quarters since that year); Item 27(b)(7)(iv) of Form N-1A (requiring premium/discount information disclosed in annual reports to span five fiscal years). The ETF is required to present premiums or discounts as a percentage of NAV and to explain that shareholders may pay more than NAV when purchasing shares and receive less than NAV when selling, because shares are bought and sold at market prices. Instructions 2, 3 to Item 11(g)(2) of Form N-1A; Instructions 2, 3 to Item 27(b)(7)(iv).

444 Item 1(a)(2) of Form N-1A; rule 498(b)(1)(ii).

445 Item 6(c)(ii) of Form N-1A. Instead ETF prospectuses could simply state that individual fund shares can only be bought and sold on the secondary market through a broker-dealer. Item 6(c)(i)(A) of Form N-1A.

446 Instruction 1(e)(ii) to Item 3 of Form N-1A; Instruction 1(e)(ii) to Item 27(d) of Form N-1A. An ETF will instead modify the narrative explanation preceding the example in the fee table to state that investors may be required to pay brokerage commissions that are not reflected in the fee table. Instruction 1(e)(i) to Item 3 of Form N-1A; Instruction 1(e)(i) to Item 27(d) of Form N-1A.

447 Item 11(g)(1) of Form N-1A.

The amendments to Form N-1A are designed to accommodate the form for use by ETFs and to meet the needs of investors (including retail investors) who purchase ETF shares in secondary market transactions rather than institutional investors purchasing creation units directly from the ETF. We anticipate that the amendments will have a negligible impact (if any) on the disclosure burdens on ETFs while providing necessary information to ETF investors. We do not believe that the amendments to Form N-1A will disproportionately impact small funds.

E. Agency Action to Minimize the Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small issuers. In connection with the amendments, the Commission considered the following alternatives: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the amendments for small entities; (3) the use of performance rather than design standards; and (4) 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, would not be appropriate or consistent with investor protection. We believe that the amendments to Form N-1A will provide investors with enhanced disclosure regarding funds. This enhanced disclosure will allow investors to better assess their investment decisions. The ETF amendments to Form N-1A are designed to accommodate the form for use by ETFs and to meet the needs of investors (including retail investors) who purchase ETF shares in secondary market transactions rather than financial institutions purchasing creation units directly from the ETF. Different disclosure requirements for funds that are small entities may create the risk that investors in these funds would be less able to evaluate funds and less able to compare different funds, thereby lessening the ability of investors to make informed choices among funds. We believe it is important for the disclosure that is required by the amendments to Form N-1A to be provided to investors in all funds, not just funds that are not considered small entities.

Rule 498 provides a new option that permits a person to satisfy its mutual fund prospectus delivery obligations under the Securities Act. Under the option, key information is to be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus is to be provided on an Internet Web site. Upon an investor's request, funds are required to send the statutory prospectus to the investor. Because the rule is optional, an exemption from the rule for small entities would deprive small entities of the potential benefits of the rule.

We have endeavored through the amendments to minimize the regulatory burden on all funds, 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 other funds. We also have endeavored to clarify, consolidate, and simplify disclosure for all funds, including those that are small entities. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context. Based on our past experience, we believe that the disclosure required by the amendments will be more useful to investors if there are enumerated informational requirements.

VIII. STATUTORY AUTHORITY

The Commission is adopting amendments to Form N-1A and Form N-4 pursuant to authority set forth in Sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)] and Sections 8, 24(a), 24(g), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-24(a), 80a-24(g), 80a-29, and 80a-37]. The Commission is adopting amendments to Form N-14 pursuant to authority set forth in Sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)]. The Commission is adopting amendments to rules 159A, 482, 485, 497, and 498 under the Securities Act and to rules 304 and 401 of Regulation S-T pursuant to authority set forth in Sections 5, 6, 7, 10, 19, and 28 of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, 77s, and 77z-3] and Sections 8, 24(a), 24(g), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-24(a), 80a-24(g), 80a-29, and 80a-37].

List of Subjects

17 CFR Parts 230 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

TEXT OF FINAL RULE AND FORM AMENDMENTS

For the reasons set out in the preamble, the Commission amends Title 17, Chapter II, of the Code of Federal Regulations as follows.

PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

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2. Section 230.159A is amended by revising the word "profile" in paragraph (a)(2) to read "summary prospectus".

3. Section 230.482 is amended by:

a. Revising paragraph (a) before the note; and

b. Revising paragraphs (b)(1) and (c).

The revisions read as follows:

§ 230.482 Advertising by an investment company as satisfying requirements of section 10.

(a) Scope of rule. This section applies to an advertisement or other sales material (advertisement) with respect to securities of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) (1940 Act), or a business development company, that is selling or proposing to sell its securities pursuant to a registration statement that has been filed under the Act. This section does not apply to an advertisement that is excepted from the definition of prospectus by section 2(a)(10) of the Act (15 U.S.C. 77b(a)(10)) or § 230.498(d) or to a summary prospectus under § 230.498. An advertisement that complies with this section, which may include information the substance of which is not included in the prospectus specified in section 10(a) of the Act (15 U.S.C 77j(a)), will be deemed to be a prospectus under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purposes of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)).

Note to paragraph (a): * * *

(b) * * *

(1) Availability of additional information. An advertisement must include a statement that advises an investor to consider the investment objectives, risks, and charges and expenses of the investment company carefully before investing; explains that the prospectus and, if available, the summary prospectus contain this and other information about the investment company; identifies a source from which an investor may obtain a prospectus and, if available, a summary prospectus; and states that the prospectus and, if available, the summary prospectus should be read carefully before investing.

* * * * *

(c) Use of applications. An advertisement that complies with this section may not contain or be accompanied by any application by which a prospective investor may invest in the investment company, except that a prospectus meeting the requirements of section 10(a) of the Act (15 U.S.C. 77j(a)) by which a unit investment trust offers variable annuity or variable life insurance contracts may contain a contract application although the prospectus includes, or is accompanied by, information about an investment company in which the unit investment trust invests that, pursuant to this section, is deemed a prospectus under section 10(b) of the Act (15 U.S.C. 77j(b)).

* * * * *

4. Section 230.485 is amended by revising the reference "Items 5 or 6(a)(2) of Form N-1A" in paragraph (b)(1)(iv) to read "Item 5(b) or 10(a)(2) of Form N-1A".

5. Section 230.497 is amended by revising paragraphs (a) and (k).

The revisions read as follows:

§230.497 Filing of investment company prospectuses – number of copies.

(a) Five copies of every form of prospectus sent or given to any person prior to the effective date of the registration statement that varies from the form or forms of prospectus included in the registration statement filed pursuant to § 230.402(a) shall be filed as part of the registration statement not later than the date that form of prospectus is first sent or given to any person, except that an investment company advertisement under § 230.482 shall be filed under this paragraph (a) (but not as part of the registration statement) unless filed under paragraph (i) of this section.

* * * * *

(k) Summary Prospectus filing requirements. This paragraph (k), and not the other provisions of § 230.497, shall govern the filing of summary prospectuses under § 230.498. Each definitive form of a summary prospectus under § 230.498 shall be filed with the Commission no later than the date that it is first used.

6. Revise Section 230.498 to read as follows:

§230.498 Summary Prospectuses for open-end management investment companies.

(a) Definitions. For purposes of this section:

(1) Class means a class of shares issued by a Fund that has more than one class that represent interests in the same portfolio of securities under § 270.18f-3 of this chapter or under an order exempting the Fund from sections 18(f), 18(g), and 18(i) of the Investment Company Act (15 U.S.C. 80a-18(f), 80a-18(g), and 80a-18(i)).

(2) Exchange-Traded Fund means a Fund or a Class, the shares of which are traded on a national securities exchange, and that has formed and operates pursuant to an

exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

(3) Fund means an open-end management investment company, or any Series of such a company, that has, or is included in, an effective registration statement on Form N-1A (§§239.15A and 274.11A of this chapter) and that has a current prospectus that satisfies the requirements of section 10(a) of the Act (15 U.S.C. 77j(a)).

(4) Series means shares offered by a Fund that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with § 270.18f-2(a) of this chapter.

(5) Statement of Additional Information means the statement of additional information required by Part B of Form N-1A.

(6) Statutory Prospectus means a prospectus that satisfies the requirements of section 10(a) of the Act.

(7) Summary Prospectus means the summary prospectus described in paragraph (b) of this section.

(b) General requirements for Summary Prospectus. This paragraph describes the requirements for a Fund's Summary Prospectus. A Summary Prospectus that complies with this paragraph (b) will be deemed to be a prospectus that is authorized under section 10(b) of the Act (15 U.S.C. 77j(b)) and section 24(g) of the Investment Company Act (15 U.S.C. 80a-24(g)) for the purposes of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)).

(1) Cover page or beginning of Summary Prospectus. Include on the cover page of the Summary Prospectus or at the beginning of the Summary Prospectus:

(i) The Fund's name and the Class or Classes, if any, to which the Summary Prospectus relates.

(ii) The exchange ticker symbol of the Fund's shares or, if the Summary Prospectus relates to one or more Classes of the Fund's shares, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's shares. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

(iii) A statement identifying the document as a "Summary Prospectus."

(iv) The approximate date of the Summary Prospectus's first use.

(v) The following legend:

Before you invest, you may want to review the Fund's prospectus, which contains more information about the Fund and its risks. You can find the Fund's prospectus and other information about the Fund online at [__________]. You can also get this information at no cost by calling [______________] or by sending an e-mail request to [__________].

(A) The legend must provide an Internet address, other than the address of the Commission's electronic filing system; toll free (or collect) telephone number; and e-mail address that investors can use to obtain the Statutory Prospectus and other information. The Internet Web site address must be specific enough to lead investors directly to the Statutory Prospectus and other materials that are required to be accessible under paragraph (e)(1) of this section, rather than to the home page or other section of the Web site on which the materials are posted. The Web site could be a central site with prominent links to each document. The legend may indicate, if applicable, that the Statutory Prospectus and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the Fund may be purchased or sold.

(B) If a Fund incorporates any information by reference into the Summary Prospectus, the legend must identify the type of document (e.g., Statutory Prospectus) from which the information is incorporated and the date of the document. If a Fund incorporates by reference a part of a document, the legend must clearly identify the part by page, paragraph, caption, or otherwise. If information is incorporated from a source other than the Statutory Prospectus, the legend must explain that the incorporated information may be obtained, free of charge, in the same manner as the Statutory Prospectus. A Fund may modify the legend to include a statement to the effect that the Summary Prospectus is intended for use in connection with a defined contribution plan that meets the requirements for qualification under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), a tax-deferred arrangement under section 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) or 457), or a variable contract as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)), as applicable, and is not intended for use by other investors.

(2) Contents of the Summary Prospectus. Except as otherwise provided in this paragraph (b), provide the information required or permitted by Items 2 through 8 of Form N-1A, and only that information, in the order required by the form. A Summary Prospectus may omit the explanation and information required by Instruction 2(c) to Item 4(b)(2) of Form N-1A.

(3) Incorporation by reference.

(i) Except as provided by paragraph (b)(3)(ii) of this section, information may not be incorporated by reference into a Summary Prospectus. Information that is incorporated by reference into a Summary Prospectus in accordance with paragraph (b)(3)(ii) of this section need not be sent or given with the Summary Prospectus.

(ii) A Fund may incorporate by reference into a Summary Prospectus any or all of the information contained in the Fund's Statutory Prospectus and Statement of Additional Information, and any information from the Fund's reports to shareholders under § 270.30e-1 that the Fund has incorporated by reference into the Fund's Statutory Prospectus, provided that:

(A) The conditions of paragraphs (b)(1)(v)(B) and (e) of this section are met;

(B) A Fund may not incorporate by reference into a Summary Prospectus information that paragraphs (b)(1) and (2) of this section require to be included in the Summary Prospectus; and

(C) Information that is permitted to be incorporated by reference into the Summary Prospectus may be incorporated by reference into the Summary Prospectus only by reference to the specific document that contains the information, not by reference to another document that incorporates such information by reference.

(iii) For purposes of § 230.159, information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with paragraph (b)(3)(ii) of this section.

(4) Multiple Funds and Classes. A Summary Prospectus may describe only one Fund, but may describe more than one Class of a Fund.

(c) Transfer of the security. Any obligation under section 5(b)(2) of the Act (15 U.S.C. 77e(b)(2)) to have a Statutory Prospectus precede or accompany the carrying or delivery of a Fund security in an offering registered on Form N-1A is satisfied if:

(1) A Summary Prospectus is sent or given no later than the time of the carrying or delivery of the Fund security;

(2) The Summary Prospectus is not bound together with any materials, except that a Summary Prospectus for a Fund that is available as an investment option in a variable annuity or variable life insurance contract may be bound together with the Statutory Prospectus for the contract and Summary Prospectuses and Statutory Prospectuses for other investment options available in the contract, provided that:

(i) All of the Funds to which the Summary Prospectuses and Statutory Prospectuses that are bound together relate are available to the person to whom such documents are sent or given; and

(ii) A table of contents identifying each Summary Prospectus and Statutory Prospectus that is bound together, and the page number on which it is found, is included at the beginning or immediately following a cover page of the bound materials;

(3) The Summary Prospectus that is sent or given satisfies the requirements of paragraph (b) of this section at the time of the carrying or delivery of the Fund security; and

(4) The conditions set forth in paragraph (e) of this section are satisfied.

(d) Sending communications. A communication relating to an offering registered on Form N-1A sent or given after the effective date of a Fund's registration statement (other than a prospectus permitted or required under section 10 of the Act) shall not be deemed a prospectus under section 2(a)(10) of the Act (15 U.S.C. 77b(a)(10)) if:

(1) It is proved that prior to or at the same time with such communication a Summary Prospectus was sent or given to the person to whom the communication was made;

(2) The Summary Prospectus is not bound together with any materials, except as permitted by paragraph (c)(2) of this section;

(3) The Summary Prospectus that was sent or given satisfies the requirements of paragraph (b) of this section at the time of such communication; and

(4) The conditions set forth in paragraph (e) of this section are satisfied.

(e) Availability of Fund's Statutory Prospectus and certain other Fund documents.

(1) The Fund's current Summary Prospectus, Statutory Prospectus, Statement of Additional Information, and most recent annual and semi-annual reports to shareholders under § 270.30e-1 are publicly accessible, free of charge, at the Web site address specified on the cover page or at the beginning of the Summary Prospectus on or before the time that the Summary Prospectus is sent or given and current versions of those documents remain on the Web site through the date that is at least 90 days after:

(i) In the case of reliance on paragraph (c) of this section, the date that the Fund security is carried or delivered; or

(ii) In the case of reliance on paragraph (d) of this section, the date that the communication is sent or given.

(2) The materials that are accessible in accordance with paragraph (e)(1) of this section must be presented on the Web site in a format, or formats, that:

(i) Are human-readable and capable of being printed on paper in human-readable format;

(ii) Permit persons accessing the Statutory Prospectus or Statement of Additional Information to move directly back and forth between each section heading in a table of contents of such document and the section of the document referenced in that section heading; provided that, in the case of the Statutory Prospectus, the table of contents is either required by § 230.481(c) or contains the same section headings as the table of contents required by § 230.481(c); and

(iii) Permit persons accessing the Summary Prospectus to move directly back and forth between:

(A) Each section of the Summary Prospectus and any section of the Statutory Prospectus and Statement of Additional Information that provides additional detail concerning that section of the Summary Prospectus; or

(B) Links located at both the beginning and end of the Summary Prospectus, or that remain continuously visible to persons accessing the Summary Prospectus, and tables of contents of both the Statutory Prospectus and the Statement of Additional Information that meet the requirements of paragraph (e)(2)(ii) of this section.

(3) Persons accessing the materials specified in paragraph (e)(1) of this section must be able to permanently retain, free of charge, an electronic version of such materials in a format, or formats, that meet each of the requirements of paragraphs (e)(2)(i) and (ii) of this section.

(4) The conditions set forth in paragraphs (e)(1), (e)(2), and (e)(3) of this section shall be deemed to be met, notwithstanding the fact that the materials specified in paragraph (e)(1) of this section are not available for a time in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section, provided that:

(i) The Fund has reasonable procedures in place to ensure that the specified materials are available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section; and

(ii) The Fund takes prompt action to ensure that the specified documents become available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section, as soon as practicable following the earlier of the time at which it knows or reasonably should have known that the documents are not available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section.

(f) Other requirements.

(1) Delivery upon request. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund (or a financial intermediary through which shares of the Fund may be purchased or sold) must send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of the Fund's Statutory Prospectus, Statement of Additional Information, and most recent annual and semi-annual reports to shareholders to any person requesting such a copy within three business days after receiving a request for a paper copy. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund (or a financial intermediary through which shares of the Fund may be purchased or sold) must send, at no cost to the requestor and by e-mail, an electronic copy of the Fund's Statutory Prospectus, Statement of Additional Information, and most recent annual and semi-annual reports to shareholders to any person requesting such a copy within three business days after receiving a request for an electronic copy. The requirement to send an electronic copy of a document by e-mail may be satisfied by sending a direct link to the document on the Internet; provided that a current version of the document is directly accessible through the link from the time that the e-mail is sent through the date that is six months after the date that the e-mail is sent and the e-mail explains both how long the link will remain useable and that,

if the recipient desires to retain a copy of the document, he or she should access and save the document.

(2) Greater prominence. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund's Summary Prospectus shall be given greater prominence than any materials, with the exception of other Summary Prospectuses or Statutory Prospectuses, that accompany the Fund's Summary Prospectus.

(3) Convenient for reading and printing. If paragraph (c) or (d) of this section is relied on with respect to a Fund:

(i) The materials that are accessible in accordance with paragraph (e)(1) of this section must be presented on the Web site in a format, or formats, that are convenient for both reading online and printing on paper; and

(ii) Persons accessing the materials that are accessible in accordance with paragraph (e)(1) of this section must be able to permanently retain, free of charge, an electronic version of such materials in a format, or formats, that are convenient for both reading online and printing on paper.

(4) Information in Summary Prospectus must be the same as information in Statutory Prospectus. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the information provided in response to Items 2 through 8 of Form N-1A in the Fund's Summary Prospectus must be the same as the information provided in response to Items 2 through 8 of Form N-1A in the Fund's Statutory Prospectus except as expressly permitted by paragraph (b)(2) of this section.

(5) Compliance with paragraph (f) not a condition to reliance on paragraphs (c) and (d). Compliance with this paragraph (f) is not a condition to the ability to rely on

paragraph (c) or (d) of this section with respect to a Fund, and failure to comply with paragraph (f) does not negate the ability to rely on paragraph (c) or (d).

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

7. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

8. Section 232.304 is amended by revising the references "Item 22 of Form N-1A" in paragraphs (d) and (e) to read "Item 27 of Form N-1A".

9. Section 232.401 is amended by:

a. Revising the reference "Item 8(a) of Form N-1A" in paragraph (b)(1)(iii) to read "Item 13(a) of Form N-1A"; and

b. Revising the reference "Items 2 and 3 of Form N-1A" in paragraph (b)(1)(iv) to read "Items 2, 3, and 4 of Form N-1A".

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

10. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u–5, 78w(a), 78ll, 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

11. Form N-14 (referenced in § 239.23) is amended by:

a. Revising paragraph (a) in Item 5;

b. Revising the reference "Items 10 through 22 of Form N-1A" in Item 12(a) to read "Items 14 through 27 of Form N-1A"; and

c. Revising the reference "Items 10 through 13 and 15 through 22 of Form N-1A" in Item 13(a) to read "Items 14 through 17 and 19 through 27 of Form N-1A".

The revision to paragraph (a) of Item 5 reads as follows:

Note: The text of Form N-14 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM N-14

* * * * *

Item 5. Information About the Registrant

* * * * *

(a) if the registrant is an open-end management investment company, furnish the information required by Items 2 through 8, 9(a), 9(b), and 10 through 13 of Form N-1A under the 1940 Act;

* * * * *

PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

12. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

13. Form N-1A (referenced in §§ 239.15A and 274.11A) is amended by:

a. Revising the Cover Page by replacing the address reference "450 5th Street, N.W., Washington, D.C. 20549-6009" with "100 F Street, NE, Washington, DC 20549-1090";

b. Revising the Table of Contents;

c. Revising the General Instructions as follows:

i. Adding the definitions "Exchange-Traded Fund" and "Market Price" in alphabetical order to paragraph A;

ii. Revising the phrase "(except Items 1, 2, 3, and 8), B, and C (except Items 23(e) and (i) – (k))" in paragraph B.2.(b) to read "(except Items 1, 2, 3, 4, and 13), B, and C (except Items 28(e) and (i) – (k))";

iii. Revising paragraphs B.4.(c), C.3.(a), C.3.(b), and C.3.(c);

iv. Revising the reference "Items 6(b)-(d) and 7(a)(2)-(5)" in paragraph C.3.(d)(i) to read "Items 6, 11(b)-(d), and 12(a)(2)-(5)"; and

v. Revising the reference "Items 2(c)(2)(iii)(B) and (C) and 2(c)(2)(iv)" in paragraph C.3.(d)(iii) to read "Items 4(b)(2)(iii)(B) and (C) and 4(b)(2)(iv)";

d. Revising Item 1 as follows:

i. Revising paragraph (a)(1);

ii. Adding new paragraph (a)(2) and redesignating paragraphs (a)(2) and (a)(3) as paragraphs (a)(3) and (a)(4);

iii. Removing Instruction 6 to Item 1(b)(1);

iv. In Item 1(b)(3), revising the telephone number "1-202-942-8090" to read "1-202-551-8090"; and

v. In Item 1(b)(3), revising the zip code "20549-0102" to read "20549-1520";

e. Redesignating Items 2, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, and 30 as Items 4, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, and 35, respectively;

f. Adding new Item 2;

g. Revising Item 3 as follows:

i. Adding a sentence after the sentence following the heading "Fees and expenses of the Fund";

ii. Revising the heading "Annual Fund Operating Expenses (expenses that are deducted from Fund assets)";

iii. Adding a new paragraph after the "Example" with the heading "Portfolio Turnover";

iv. Revising Instruction 1(b);

v. Adding new Instruction 1(e);

vi. In Instruction 2(a)(i), revising the reference "Item 7(a)" to read "Item 12(a)";

vii. Revising Instruction 3(e);

viii. In Instruction 3(f)(iii), revising the references "Item 8(a)" to read "Item 13(a)";

ix. In Instruction 3(f)(vii), revising the reference "Item 8" to read "Item 13";

x. Revising Instruction 4(a);

xi. Redesignating Instruction 5 as Instruction 6 and adding new Instruction 5; and

xii. In newly redesignated Instruction 6, removing paragraph (b) and redesignating paragraph (c) as paragraph (b);

h. Revising newly redesignated Item 4 as follows:

i. Removing paragraph (a) and redesignating paragraphs (b) and (c) as paragraphs (a) and (b);

ii. In newly redesignated Item 4(a), revising the reference "Item 4(b)" to read "Item 9(b)";

iii. In newly redesignated Item 4(b)(1)(i), revising the reference "Item 4(c)" to read "Item 9(c)";

iv. In the Instruction to newly redesignated Item 4(b)(1)(iii), revising the reference "Items 2(c)(1)(ii) and (iii)" to read "Items 4(b)(1)(ii) and (iii)";

v. Revising newly redesignated Item 4(b)(2)(i);

vi. In newly redesignated Item 4(b)(2)(iii), revising the reference "Item 22(b)(7)" to read "Item 27(b)(7)";

vii. In newly redesignated Item 4(b)(2)(iv), revising the reference "paragraph 2(c)(2)(iii)" to read "paragraph 4(b)(2)(iii)";

viii. In Instruction 1(a) to newly redesignated Item 4(b)(2), revising the reference "Item 8(a)" to read "Item 13(a)";

ix. In Instruction 1(b) to newly redesignated Item 4(b)(2), revising the reference "paragraph (c)(2)(i)" to read "paragraph (b)(2)(i)";

x. In Instruction 2(a) to newly redesignated Item 4(b)(2), revising the references "Item 21(a)", "Item 21(b)(1)", and "Items 21(b)(2) and (3)" to read "Item 26(a)", "Item 26(b)(1)", and "Items 26(b)(2) and (3)", respectively;

xi. In Instruction 2(b) to newly redesignated Item 4(b)(2), revising the reference "Item 22(b)(7)" to read "Item 27(b)(7)";

xii. In Instruction 2(d) to newly redesignated Item 4(b)(2), revising the references "Item 21(b)(2)" and "Item 21" to read "Item 26(b)(2)" and "Item 26", respectively;

xiii. In newly redesignated Item 4(b)(2), revising Instructions 2(e), 3(a), 3(b), and 3(c);

xiv. In Instruction 3(c)(ii)(D) to newly redesignated Item 4(b)(2), revising the reference "paragraphs 2(c)(2)(iii)(B) and (C)" to read "paragraphs 4(b)(2)(iii)(B) and (C)";

xv. In Instruction 3(c)(iii) to newly redesignated Item 4(b)(2), revising the reference "paragraphs 2(c)(2)(iii)(A), (B), and (C)" to read "paragraphs 4(b)(2)(iii)(A), (B), and (C)"; and

xvi. In Instruction 4 to newly redesignated Item 4(b)(2), revising the reference "Item 22(b)(7)" to read "Item 27(b)(7)";

i. Adding new Items 5, 6, 7, and 8;

j. In Instruction 5 to newly redesignated Item 9(b)(1), revising the reference "Item 11(c)(1)" to read "Item 16(c)(1)";

k. Revising newly redesignated Item 10 as follows:

i. Revising paragraph (a)(1)(i);

ii. Revising paragraph (a)(2); and

iii. Removing the Instructions to newly redesignated Item 10(a)(2);

l. Revising newly redesignated Item 11 as follows:

i. Revising paragraph (a)(1);

ii Revising paragraph (b); and

iii. Revising paragraph (g);

m. Revising newly redesignated Item 12 as follows:

i. In Instruction 1 to newly redesignated Item 12(a)(2), revising the reference "Item 7" to read "Item 12";

ii. In Instruction 2 to newly redesignated Item 12(a)(2), revising the references "Item 7" and "Items 12(d) and 17(b)" to read "Item 12" and "Items 17(d) and 22(b)", respectively;

iii. In newly redesignated Item 12(a)(5), revising the reference "Item 17(a)" to read "Item 22(a)"; and

iv. In the Instruction to newly redesignated Item 12(a)(5), revising the references "Item 7" to read "Item 12";

n. Revising newly redesignated Item 14 as follows:

i. Revising paragraph (a)(1); and

ii. Adding new paragraph (a)(2) and redesignating paragraphs (a)(2) and (a)(3) as paragraphs (a)(3) and (a)(4);

o. Revising newly redesignated Item 16 as follows:

i. In newly redesignated Item 16(d), revising the reference "Item 4(b)" to read "Item 9(b)";

ii. In newly redesignated Item 16(e), revising the reference "Item 8" to read "Item 13"; and

iii. In Instruction 1 to newly redesignated Item 16(f)(2), revising the reference "Item 11(f)(2)" to read "Item 16(f)(2)";

p. In newly redesignated Item 17, revising the references "Item 12" to read "Item 17";

q. In newly redesignated Items 20(a), 20(b), and 20(c), revising the references "Item 5(a)(2)" to read "Item 5(b)";

r. Revising newly redesignated Item 23 as follows:

i. Removing the Instruction to newly redesignated Item 23(a);

ii. In Instruction 4 to newly redesignated Item 23(c), revising the reference "Item 22" to read "Item 27"; and

iii. In Instruction 1 to newly redesignated Item 23(e), revising the reference "Item 17(e)" to read "Item 23(e)";

s. In Instruction 1 to newly redesignated Item 25(c), revising the references "Item 7(b)(2)", "Item 14(d)", and "Item 30" to read "Item 12(b)(2)", "Item 19(d)", and "Item 34", respectively;

t. Revising newly redesignated Item 27 as follows:

i. In newly redesignated Item 27(a), revising the reference "Item 17(c)" to read "Item 23(c)";

ii. In newly redesignated Item 27(b)(2), revising the reference "Item 8(a)" to read "Item 13(a)";

iii. In newly redesignated Item 27(b)(5), revising the reference "Item 12(a)(1)" to read "Item 17(a)(1)";

iv. In newly redesignated Item 27(b)(7)(ii)(B), revising the reference "Item 21(b)(1)" to read "Item 26(b)(1)";

v. In newly redesignated Item 27(b)(7), adding new paragraph (iv);

vi. In Instruction 10 to newly redesignated Item 27(b)(7), revising the reference "Instruction 5 to Item 3" to read "Instruction 6 to Item 3";

vii. In the Instruction to newly redesignated Item 27(c)(1), revising the references "Item 22(b)(1)" and "Item 22(c)(1)" to read "Item 27(b)(1)" and "Item 27(c)(1)", respectively;

viii. In newly redesignated Item 27(c)(2), revising the reference "Item 8(a)" to read "Item 13(a)";

ix. In Instruction 1(c) to newly redesignated Item 27(d)(1), revising the reference "Item 8(a)" to read "Item 13(a)";

x. In newly redesignated Item 27(d)(1), adding Instruction 1(e);

xi. In Instruction 2(a)(ii) to newly redesignated Item 27(d)(1), revising the reference "Item 22(d)(1)" to read "Item 27(d)(1)"; and

xii. In the Instruction to newly redesignated Item 27(d)(4), revising the reference "Item 12(f)" to read "Item 17(f)";

u. In newly redesignated Item 28(k), revising the reference "Item 22" to read "Item 27";

v. Revising newly redesignated Item 32 as follows:

i. In newly redesignated Item 32(b), revising the reference "Item 20" to read "Item 25";

ii. In Instruction 2 to newly redesignated Item 32(c), revising the reference "Item 20(c)" to read "Item 25(c)"; and

w. In Instruction 1 to newly redesignated Item 34, revising the reference "Item 14" to read "Item 19".

The additions and revisions are to read as follows:

Note: The text of Form N-1A does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM N-1A

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CONTENTS OF FORM N-1A

PART B:	**INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION**
Item 14.	**Cover Page and Table of Contents**
Item 15.	**Fund History**
Item 16.	**Description of the Fund and Its Investments and Risks**
Item 17.	**Management of the Fund**
Item 18.	**Control Persons and Principal Holders of Securities**
Item 19.	**Investment Advisory and Other Services**
Item 20.	**Portfolio Managers**
Item 21.	**Brokerage Allocation and Other Practices**
Item 22.	**Capital Stock and Other Securities**
Item 23.	**Purchase, Redemption, and Pricing of Shares**
Item 24.	**Taxation of the Fund**
Item 25.	**Underwriters**
Item 26.	**Calculation of Performance Data**
Item 27.	**Financial Statements**
PART C:	**OTHER INFORMATION**
Item 28.	**Exhibits**
Item 29.	**Persons Controlled by or Under Common Control with the Fund**
Item 30.	**Indemnification**
Item 31.	**Business and Other Connections of the Investment Adviser**
Item 32.	**Principal Underwriters**
Item 33.	**Location of Accounts and Records**
Item 34.	**Management Services**

Item 35. Undertakings

SIGNATURES

GENERAL INSTRUCTIONS

A. Definitions

* * * * *

"Exchange-Traded Fund" means a Fund or Class, the shares of which are traded on a national securities exchange, and that has formed and operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

* * * * *

"Market Price" refers to the last reported sale price at which Exchange-Traded Fund shares trade on the principal U.S. market on which the Fund's shares are traded during a regular trading session or, if it more accurately reflects the current market value of the Fund's shares at the time the Fund uses to calculate its net asset value, a price within the range of the highest bid and lowest offer on the principal U.S. market on which the Fund's shares are traded during a regular trading session.

* * * * *

B. Filing and Use of Form N-1A

* * * * *

4. * * *

(c) The plain English requirements of rule 421 under the Securities Act [17 CFR 230.421] apply to prospectus disclosure in Part A of Form N-1A. The information required by Items 2 through 8 must be provided in plain English under rule 421(d) under the Securities Act.

* * * * *

C. **Preparation of the Registration Statement**

* * * * *

3. * * *

(a) Organization of Information. Organize the information in the prospectus and SAI to make it easy for investors to understand. Notwithstanding rule 421(a) under the Securities Act regarding the order of information required in a prospectus, disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus. Do not precede these Items with any other Item except the Cover Page (Item 1) or a table of contents meeting the requirements of rule 481(c) under the Securities Act. Information that is included in response to Items 2 through 8 need not be repeated elsewhere in the prospectus. Disclose the information required by Item 12 (Distribution Arrangements) in one place in the prospectus.

(b) Other Information. A Fund may include, except in response to Items 2 through 8, information in the prospectus or the SAI that is not otherwise required. For example, a Fund may include charts, graphs, or tables so long as the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included. Items 2 through 8 may not include disclosure other than that required or permitted by those Items.

(c) Use of Form N-1A by More Than One Registrant, Series, or Class. Form N-1A may be used by one or more Registrants, Series, or Classes.

(i) When disclosure is provided for more than one Fund or Class, the disclosure should be presented in a format designed to communicate the information effectively. Except as required by paragraph (c)(ii) for Items 2 through 8, Funds may order or group the response to any Item in any manner that organizes the information into readable and comprehensible segments and is consistent with the intent of the prospectus to provide clear and concise information about the Funds or Classes. Funds are encouraged to use, as appropriate, tables, side-by-side comparisons, captions, bullet points, or other organizational techniques when presenting disclosure for multiple Funds or Classes.

(ii) Paragraph (a) requires Funds to disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus and not to precede Items 2 through 8 with other information. Except as permitted by paragraph (c)(iii), a prospectus that contains information about more than one Fund must present all of the information required by Items 2 through 8 for each Fund sequentially and may not integrate the information for more than one Fund together. That is, a prospectus must present all of the information for a particular Fund that is required by Items 2 through 8 together, followed by all of the information for each additional Fund, and may not, for example, present all of the Item 2 (Risk/Return Summary: Investment Objectives/Goals) information for several Funds followed by all of the Item 3 (Risk/Return Summary: Fee Table) information for several Funds. If a prospectus contains information about multiple Funds, clearly identify the name of the relevant Fund at the beginning of the information for the Fund that is required by Items 2 through 8. A Multiple Class Fund may present the information required by Items 2 through 8 separately for each Class or may integrate the information for multiple Classes, although the order of the information must be as prescribed in Items 2 through 8. For example, the prospectus may present all of the Item 2 (Risk/Return Summary: Investment Objectives/Goals) information for several Classes followed by all of the Item 3 (Risk/Return Summary: Fee Table) information for the Classes, or may present Items 2 and 3 for each of several Classes sequentially. Other presentations of multiple Class information also would be acceptable if they are consistent with the Form's intent to disclose the information required by Items 2 through 8 in a standard order at the beginning of the prospectus. For a Multiple Class Fund, clearly identify the relevant Classes at the beginning of the Items 2 through 8 information for those Classes.

(iii) A prospectus that contains information about more than one Fund may integrate the information required by any of Items 6 through 8 for all of the Funds together, provided that the information contained in any Item that is integrated is identical for all Funds covered in the prospectus. If the information required by any of Items 6 through 8 is integrated pursuant to this paragraph, the integrated information should be presented immediately following the separate presentations of Item 2 through 8 information for individual Funds. In addition, include a statement containing the following information in each Fund's separate presentation of Item 2 through 8 information, in the location where the integrated information is omitted: "For important information about [purchase and sale of fund shares,] [tax information,] and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

* * * * *

PART A: INFORMATION REQUIRED IN A PROSPECTUS

Item 1. Front and Back Cover Pages

(a) Front Cover Page. Include the following information, in plain English under rule 421(d) under the Securities Act, on the outside front cover page of the prospectus:

(1) The Fund's name and the Class or Classes, if any, to which the prospectus relates.

(2) The exchange ticker symbol of the Fund's shares or, if the prospectus relates to one or more Classes of the Fund's shares, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's shares. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

* * * * *

Item 2. Risk/Return Summary: Investment Objectives/Goals

Disclose the Fund's investment objectives or goals. A Fund also may identify its type or category (<u>e.g.</u>, that it is a Money Market Fund or a balanced fund).

Item 3. Risk/Return Summary: Fee Table

* * * * *

<u>Fees and expenses of the Fund</u>

* * * **You may qualify for sales charge discounts if you and your family invest, or agree to invest in the future, at least $[________] in [name of fund family] funds. More information about these and other discounts is available from your financial professional and in [identify section heading and page number] of the Fund's prospectus and [identify section heading and page number] of the Fund's statement of additional information.**

* * * * *

<u>Annual Fund Operating Expenses</u> (expenses that you pay each year as a percentage of the value of your investment)

* * * * *

Example

*   *   *   *   *

Portfolio Turnover

The Fund pays transaction costs, such as commissions, when it buys and sells securities (or "turns over" its portfolio). A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when Fund shares are held in a taxable account. These costs, which are not reflected in annual fund operating expenses or in the example, affect the Fund's performance. During the most recent fiscal year, the Fund's portfolio turnover rate was __% of the average value of its portfolio.

Instructions.

1. General.

(a) *   *   *

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown. The narrative explanation regarding sales charge discounts is only required by a Fund that offers such discounts and should specify the minimum level of investment required to qualify for a discount as disclosed in the table required by Item 12(a)(1).

*   *   *   *   *

(e) If the Fund is an Exchange-Traded Fund,

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

* * * * *

3. Annual Fund Operating Expenses.

(a) * * *

(e) If there are expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement, a Fund may add two captions to the table: one caption showing the amount of the expense reimbursement or fee waiver, and a second caption showing the Fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. The Fund should place these additional captions directly below the "Total Annual Fund Operating Expenses" caption of the table and should use appropriate descriptive captions, such as "Fee Waiver [and/or Expense Reimbursement]" and "Total Annual Fund Operating Expenses After Fee Waiver [and/or Expense Reimbursement]," respectively. If the Fund provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances.

* * * * *

4. Example.

(a) Assume that the percentage amounts listed under "Total Annual Fund Operating Expenses" remain the same in each year of the 1-, 3-, 5-, and 10-year periods, except that an adjustment may be made to reflect any expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement. An adjustment to reflect any expense reimbursement or fee waiver arrangement may be reflected only in the period(s) for which the expense reimbursement or fee waiver arrangement is expected to continue.

* * * * *

5. Portfolio Turnover. Disclose the portfolio turnover rate provided in response to Item 13(a) for the most recent fiscal year (or for such shorter period as the Fund has been in operation). Disclose the period for which the information is provided if less than a full fiscal year. A Fund that is a Money Market Fund may omit the portfolio turnover information required by this Item.

* * * * *

Item 4. Risk/Return Summary: Investments, Risks, and Performance

* * * * *

(b) Principal risks of investing in the Fund.

* * * * *

(2) Risk/Return Bar Chart and Table.

(i) Include the bar chart and table required by paragraphs (b)(2)(ii) and (iii) of this section. Provide a brief explanation of how the information illustrates the variability of the Fund's returns (e.g., by stating that the information provides some indication of the risks of investing in the Fund by showing changes in the Fund's performance from year to year and by showing how the Fund's average annual returns for 1, 5, and 10 years compare with those of a broad measure of market performance). Provide a statement to the effect that the Fund's past performance (before and after taxes) is not necessarily an indication of how the Fund will perform in the future. If applicable, include a statement explaining that updated performance information is available and providing a Web site address and/or toll-free (or collect) telephone number where the updated information may be obtained.

* * * * *

Instructions.

* * * * *

2. Table.

* * * * *

(e) Returns required by paragraphs 4(b)(2)(iii)(A), (B), and (C) for a Fund or Series must be adjacent to one another and appear in that order. The returns for a broad-based securities market index, as required by paragraph 4(b)(2)(iii), must precede or follow all of the returns for a Fund or Series rather than be interspersed with the returns of the Fund or Series.

3. Multiple Class Funds.

(a) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2), provide annual total returns in the bar chart for only one of those Classes. The Fund can select which Class to include (e.g., the oldest Class, the Class with the greatest net assets) if the Fund:

(i) Selects the Class with 10 or more years of annual returns if other Classes have fewer than 10 years of annual returns;

(ii) Selects the Class with the longest period of annual returns when the Classes all have fewer than 10 years of returns; and

(iii) If the Fund provides annual total returns in the bar chart for a Class that is different from the Class selected for the most immediately preceding period, explain in a footnote to the bar chart the reasons for the selection of a different Class.

(b) When a Multiple Class Fund offers a new Class in a prospectus and separately presents information for the new Class in response to Item 4(b)(2), include the bar chart with annual total returns for any other existing Class for the first year that the Class is offered. Explain in a footnote that the returns are for a Class that is not presented that would have substantially similar annual returns because the shares are invested in the same portfolio of securities and the annual returns would differ only to the extent that the Classes do not have the same expenses. Include return information for the other Class reflected in the bar chart in the performance table.

(c) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2):

(i) Provide the returns required by paragraph 4(b)(2)(iii)(A) of this Item for each of the Classes;

(ii) Provide the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item for only one of those Classes. The Fund may select the Class for which it provides the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item, provided that the Fund:

* * * * *

Item 5. Management

(a) <u>Investment Adviser(s)</u>. Provide the name of each investment adviser of the Fund, including sub-advisers.

<u>Instructions</u>.

1. A Fund need not identify a sub-adviser whose sole responsibility for the Fund is limited to day-to-day management of the Fund's holdings of cash and cash equivalent instruments, unless the Fund is a Money Market Fund or other Fund with a principal investment strategy of regularly holding cash and cash equivalent instruments.

2. A Fund having three or more sub-advisers, each of which manages a portion of the Fund's portfolio, need not identify each such sub-adviser, except that the Fund must identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the Fund's net assets. For purposes of this paragraph, a significant portion of a Fund's net assets generally will be deemed to be 30% or more of the Fund's net assets.

(b) Portfolio Manager(s). State the name, title, and length of service of the person or persons employed by or associated with the Fund or an investment adviser of the Fund who are primarily responsible for the day-to-day management of the Fund's portfolio ("Portfolio Manager").

Instructions.

1. This requirement does not apply to a Money Market Fund.

2. If a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, information in response to this Item is required for each member of such committee, team, or other group. If more than five persons are jointly and primarily responsible for the day-to-day management of the Fund's portfolio, the Fund need only provide information for the five persons with the most significant responsibility for the day-to-day management of the Fund's portfolio.

Item 6. Purchase and Sale of Fund Shares

(a) Purchase of Fund Shares. Disclose the Fund's minimum initial or subsequent investment requirements.

(b) Sale of Fund Shares. Also disclose that the Fund's shares are redeemable and briefly identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer).

(c) Exchange-Traded Funds. If the Fund is an Exchange-Traded Fund,

(i) Specify the number of shares that the Fund will issue (or redeem) in exchange for the deposit or delivery of basket assets (i.e., the securities or other assets the Fund specifies each day in name and number as the securities or assets in exchange for which it will issue or in return for which it will redeem Fund shares) and explain that:

(A) Individual Fund shares may only be purchased and sold on a national securities exchange through a broker-dealer; and

(B) The price of Fund shares is based on market price, and because Exchange-Traded Fund shares trade at market prices rather than net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount); and

(ii) If the Fund issues shares in creation units of not less than 25,000 shares each, the Fund may omit the information required by Items 6(a) and 6(b).

Item 7. Tax Information

State, as applicable, that the Fund intends to make distributions that may be taxed as ordinary income or capital gains or that the Fund intends to distribute tax-exempt income. For a Fund that holds itself out as investing in securities generating tax-exempt income, provide, as applicable, a general statement to the effect that a portion of the Fund's distributions may be subject to federal income tax.

Item 8. Financial Intermediary Compensation

Include the following statement. A Fund may modify the statement if the modified statement contains comparable information. A Fund may omit the statement if neither the Fund nor any of its related companies pay financial intermediaries for the sale of Fund shares or related services.

Payments to Broker-Dealers and Other Financial Intermediaries.

If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information.

*   *   *   *   *

Item 10. Management, Organization, and Capital Structure

(a) Management.

(1) Investment Adviser.

(i) Provide the name and address of each investment adviser of the Fund, including sub-advisers. Describe the investment adviser's experience as an investment adviser and the advisory services that it provides to the Fund.

*   *   *   *   *

(2) Portfolio Manager. For each Portfolio Manager identified in response to Item 5(b), state the Portfolio Manager's business experience during the past 5 years. Include a statement, adjacent to the foregoing disclosure, that the SAI provides additional information about the Portfolio Manager's(s') compensation, other accounts managed by

the Portfolio Manager(s), and the Portfolio Manager's(s') ownership of securities in the Fund. If a Portfolio Manager is a member of a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund that is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, provide a brief description of the person's role on the committee, team, or other group (e.g., lead member), including a description of any limitations on the person's role and the relationship between the person's role and the roles of other persons who have responsibility for the day-to-day management of the Fund's portfolio.

* * * * *

Item 11. Shareholder Information

(a) * * *

(1) An explanation that the price of Fund shares is based on the Fund's net asset value and the method used to value Fund shares (market price, fair value, or amortized cost); except that if the Fund is an Exchange-Traded Fund, an explanation that the price of Fund shares is based on market price.

* * * * *

(b) Purchase of Fund Shares. Describe the procedures for purchasing the Fund's shares.

* * * * *

(g) Exchange-Traded Funds. If the Fund is an Exchange-Traded Fund:

(1) The Fund may omit from the prospectus the information required by Items 11(a)(2), (b), and (c) if the Fund issues or redeems Fund shares in creation units of not less than 25,000 shares each; and

(2) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit this table if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in this Item.

Instructions.

1. Provide the information in tabular form.

2. Express the information as a percentage of the net asset value of the Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.

3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.

4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

* * * * *

Item 14. Cover Page and Table of Contents

(a) Front Cover Page. Include the following information on the outside front cover page of the SAI:

(1) The Fund's name and the Class or Classes, if any, to which the SAI relates. If the Fund is a Series, also provide the Registrant's name.

(2) The exchange ticker symbol of the Fund's securities or, if the SAI relates to one or more Classes of the Fund's securities, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's securities. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

* * * * *

Item 27. Financial Statements

* * * * *

(b) Annual Report. * * *

* * * * *

(7) Management's Discussion of Fund Performance. * * *

* * * * *

(iv) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed five fiscal years (or the life of the Fund, if shorter). The Fund may omit this table from the annual report if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in Item 11(g)(2).

Instructions.

1. Provide the information in tabular form.

2. Express the information as a percentage of the net asset value of the Exchange-Traded Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.

3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.

4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

* * * * *

(d) Annual and Semi-Annual Reports. * * *

(1) Expense Example. * * *

* * * * *

Instructions.

1. General.

* * * * *

(e) If the Fund is an Exchange-Traded Fund:

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

* * * * *

14. Form N-4 (referenced in §§ 239.17b and 274.11c) is amended by revising the reference "Item 22(b)(ii) of Form N-1A" to read "Item 27(b)(ii) of Form N-1A" and by revising the reference "Item 22(b)(ii) equation" to read "Item 27(b)(ii) equation" in Instruction 3 to Item 20(b)(ii).

Note: The text of Form N-4 does not, and these amendments will not, appear in the Code of Federal Regulations.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

January 13, 2009

Commissioner Paredes
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33-8996, 34-59221; File No. S7-14-08]

RIN 3235-AK16

INDEXED ANNUITIES AND CERTAIN OTHER INSURANCE CONTRACTS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting a new rule that defines the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933. The 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 rule applies on a prospective basis to contracts issued on or after the effective date of the rule. We are also adopting a new rule that exempts 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 certain conditions are satisfied, including 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.

EFFECTIVE DATE: The effective date of § 230.151A is January 12, 2011. The effective date of § 240.12h-7 is May 1, 2009. Sections III.A.3. and III.B.3. of this release discuss the effective dates applicable to rule 151A and rule 12h-7, respectively.

FOR FURTHER INFORMATION CONTACT: Michael L. Kosoff, Attorney, or 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 adding rule 151A under the Securities Act of 1933 ("Securities Act") [1] and rule 12h-7 under the Securities Exchange Act of 1934 ("Exchange Act").[2]

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1 15 U.S.C. 77a et seq.

2 15 U.S.C. 78a et seq.

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

We are adopting new rule 151A under the Securities Act of 1933 in order 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.[3] Section 3(a)(8) of the Securities Act provides an exemption under the Securities Act for certain "annuity contracts," "optional annuity contracts," and other insurance contracts. The new rule prospectively defines certain indexed annuities as not being "annuity contracts" or "optional annuity contracts" under this exemption if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

The definition hinges upon a familiar concept: the allocation of risk. Insurance provides protection against risk, and the courts have held that the allocation of investment risk is a significant factor in distinguishing a security from a contract of insurance. The Commission has also recognized that the allocation of investment risk is significant in determining whether a particular contract that is regulated as insurance under state law is insurance for purposes of the federal securities laws.

Individuals who purchase indexed annuities are exposed to a significant investment risk – i.e., the volatility of the underlying securities index. Insurance companies have successfully utilized this investment feature, which appeals to purchasers not on the usual insurance basis of stability and security, but on the prospect of investment growth. Indexed annuities are attractive to purchasers because they offer the

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3 17 CFR 230.151A. Rule 151A was proposed by the Commission in June 2008. See Securities Act Release No. 8933 (June 25, 2008) [73 FR 37752 (July 1, 2008)] ("Proposing Release").

promise of market-related gains. Thus, purchasers obtain indexed annuity contracts for many of the same reasons that individuals purchase mutual funds and variable annuities, and open brokerage accounts.

When the amounts payable by an insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract, this indicates that the majority of the investment risk for the fluctuating, securities-linked portion of the return is borne by the individual purchaser, not the insurer. The individual underwrites the effect of the underlying index's performance on his or her contract investment and assumes the majority of the investment risk for the securities-linked returns under the contract.

The federal interest in providing investors with disclosure, antifraud, and sales practice protections arises when individuals are offered indexed annuities that expose them to investment risk. Individuals who purchase such indexed annuities assume many of the same risks and rewards that investors assume when investing their money in mutual funds, variable annuities, and other securities. However, a fundamental difference between these securities and indexed annuities is that – with few exceptions – indexed annuities historically have not been registered as securities. As a result, most purchasers of indexed annuities have not received the benefits of federally mandated disclosure, antifraud, and sales practice protections.

In a traditional fixed annuity, the insurer bears the investment risk under the contract. As a result, such instruments have consistently been treated as insurance contracts under the federal securities laws. At the opposite end of the spectrum, the purchaser bears the investment risk for a traditional variable annuity that passes through to the purchaser the performance of underlying securities, and we have determined and the courts have held that variable annuities are securities under the federal securities laws. Indexed annuities, on the other hand, fall somewhere in between -- they possess both securities and insurance features. Therefore, we have determined that providing greater clarity with regard to the status of indexed annuities under the federal securities laws will enhance investor protection, as well as provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. Accordingly, we are adopting a new definition of "annuity contract" that, on a prospective basis, will define a class of indexed annuities that are outside the scope of Section 3(a)(8). We carefully considered where to draw the line, and we believe that the line that we have drawn, which will be applied on a prospective basis only, is rational and reasonably related to fundamental concepts of risk and insurance. That is, if more often than not the purchaser of an indexed annuity will receive a guaranteed return like that of a traditional fixed annuity, then the instrument will be treated as insurance; on the other hand, if more often than not the purchaser will receive a return based on the value of a security, then the instrument will be treated as a security. With respect to the latter group of indexed annuities, investors will be entitled to all the protections of the federal securities laws, including full and fair disclosure and antifraud and sales practice protections.

We are aware that many insurance companies and sellers of indexed annuities, in the absence of definitive interpretation or definition by the Commission, have of necessity acted in reliance on their own analysis of the legal status of indexed annuities based on the state of the law prior to the proposal and adoption of rule 151A. Under these circumstances, we do not believe that insurance companies and sellers of indexed annuities should be subject to any additional legal risk relating to their past offers and sales of indexed annuities as a result of the proposal and adoption of rule 151A. Therefore, the new definition will apply prospectively only – that is, only to indexed annuities that are issued on or after the effective date of our final rule.

Finally, we are adopting rule 12h-7 under the Exchange Act, a new exemption from Exchange Act reporting that will apply to insurance companies with respect to indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law. We believe that this exemption is necessary or appropriate in the public interest and consistent with the protection of investors. Where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law, and where there is no trading interest in an insurance contract, the concerns that periodic and current financial disclosures are intended to address are generally not implicated.

The Commission received approximately 4,800 comments on the proposed rules. The commenters were divided with respect to proposed rule 151A. Many issuers and sellers of indexed annuities opposed the proposed rule. However, other commenters supported the proposed rule, including the North American Securities Administrators Association, Inc. ("NASAA"),[4] the Financial Industry Regulatory Authority, Inc. ("FINRA"),[5] several insurance companies, and the Investment Company Institute

4 NASAA is the association of all state, provincial, and territorial securities regulators in North America.

5 FINRA is the largest non-governmental regulator for registered broker-dealer firms doing business in the United States. FINRA was created in July 2007 through the consolidation

("ICI").[6] A number of commenters, both those who supported and those who opposed rule 151A, suggested modifications to the proposed rule. Sixteen commenters addressed proposed rule 12h-7, and all of these commenters supported the proposal, with some suggesting modifications. We are adopting proposed rules 151A and 12h-7, with significant modifications to address the concerns of commenters.

II. BACKGROUND

Beginning in the mid-1990s, the life insurance industry introduced a new type of annuity, referred to as an "equity-indexed annuity," or, more recently, "fixed indexed annuity" (herein "indexed annuity"). Amounts paid by the insurer to the purchaser of an indexed annuity are based, in part, on the performance of an equity index or another securities index, such as a bond index.

The status of indexed annuities under the federal securities laws has been uncertain since their introduction in the mid-1990s.[7] Under existing precedents, the status of each indexed annuity is determined based on a facts and circumstances analysis

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of NASD and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange.

6 ICI is a national association of investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts.

7 See Securities Act Release No. 7438 (Aug. 20, 1997) [62 FR 45359, 45360 (Aug. 27, 1997)] ("1997 Concept Release"); NASD, Equity-Indexed Annuities, Notice to Members 05-50 (Aug. 2005), available at: http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p014821.pdf ("NTM 05-50"); Letter of William A. Jacobson, Esq., Associate Clinical Professor, Director, Securities Law Clinic, and Matthew M. Sweeney, Cornell Law School '10, Cornell University Law School (Sept. 10, 2008) ("Cornell Letter"); Letter of FINRA (Aug. 11, 2008) ("FINRA Letter"); Letter of Investment Company Institute (Sept. 10, 2008) ("ICI Letter").

of factors that have been articulated by the U.S. Supreme Court.[8] Insurers have typically marketed and sold indexed annuities without registering the contracts under the federal securities laws.

In the years after indexed annuities were first introduced, sales volumes and the number of purchasers were relatively small. Sales of indexed annuities for 1998 totaled $4 billion and grew each year through 2005, when sales totaled $27.2 billion.[9] Indexed annuity sales for 2006 totaled $25.4 billion and $24.8 billion in 2007.[10] In 2007, indexed annuity assets totaled $123 billion, 58 companies were issuing indexed annuities, and there were a total of 322 indexed annuity contracts offered.[11] As sales have grown in more recent years, these products have affected larger and larger numbers of purchasers. They have also become an increasingly important business line for some insurers.[12]

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8 SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) ("VALIC"); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) ("United Benefit").

9 NAVA, 2008 Annuity Fact Book, at 57 (2008).

10 Id.

11 Id.

12 See, e.g., Allianz Life Insurance Company of North America (Best's Company Reports, Allianz Life Ins. Co. of N. Am., Dec. 3, 2007) (Indexed annuities represent approximately two-thirds of gross premiums written.); American Equity Investment Life Holding Company (Annual Report on Form 10-K, at F-16 (Mar. 14, 2008)) (Indexed annuities accounted for approximately 97% of total purchase payments in 2007.); Americo Financial Life and Annuity Insurance Company (Best's Company Reports, Americo Fin. Life and Annuity Ins. Co., Sept. 5, 2008) (Indexed annuities represent over 90% of annuity premiums and almost 60% of annuity reserves.); Aviva USA Group (Best's Company Reports, Aviva Life Insurance Company, July 14, 2008) (Indexed annuity sales represent more than 85% of total annuity production.); Investors Insurance Corporation (IIC) (Best's Company Reports, Investors Ins. Corp., July 10, 2008) (IIC's primary product has been indexed annuities.); Life Insurance Company of the Southwest ("LSW") (Best's Company Reports, Life Ins. Co. of the Southwest, June 28, 2007) (LSW specializes in the sale of annuities, primarily indexed annuities.); Midland National Life Insurance Company (Best's Company Reports, Midland Nat'l Life Ins. Co., Jan. 24, 2008)

The growth in sales of indexed annuities has, unfortunately, been accompanied by complaints of abusive sales practices. These include claims that the often-complex features of these annuities have not been adequately disclosed to purchasers, as well as claims that rapid sales growth has been fueled by the payment of outsize commissions that are funded by high surrender charges imposed over long periods, which can make these annuities unsuitable for seniors and others who may need ready access to their assets.[13]

We have observed the development of indexed annuities for some time and have become persuaded that guidance is needed with respect to their status under the federal securities laws. Given the current size of the market for indexed annuities, we believe that it is important for all parties, including issuers, sellers, and purchasers, to understand, in advance, the legal status of these products and the rules and protections that apply.

(Sales of indexed annuities in recent years have been the principal driver of growth in annuity deposits.).

13 See Letter of Susan E. Voss, Commissioner, Iowa Insurance Division (Nov. 18, 2008) ("Voss Letter") (acknowledging sales practice issues and "great deal" of concern about suitability and disclosures in indexed annuity market). See also FINRA, Equity Indexed Annuities – A Complex Choice (updated Apr. 22, 2008), available at: http://www.finra.org/InvestorInformation/InvestorAlerts/AnnuitiesandInsurance/Equity-IndexedAnnuities-AComplexChoice/P010614 ("FINRA Investor Alert") (investor alert on indexed annuities); Office of Compliance Inspections and Examinations, Securities and Exchange Commission, et al., Protecting Senior Investors: Report of Examinations of Securities Firms Providing 'Free Lunch' Sales Seminars, at 4 (Sept. 2007), available at: http://www.sec.gov/spotlight/seniors/freelunchreport.pdf (joint examination conducted by Commission, North American Securities Administrators Association ("NASAA"), and FINRA identified potentially misleading sales materials and potential suitability issues relating to products discussed at sales seminars, which commonly included indexed annuities); Statement of Patricia Struck, President, NASAA, at the Senior Summit of the United States Securities and Exchange Commission, July 17, 2006, available at: http://www.nasaa.org/Issues___Answers/Legislative_Activity/Testimony/4999.cfm (identifying indexed annuities as among the most pervasive products involved in senior investment fraud); NTM 05-50, supra note 7 (citing concerns about marketing of indexed annuities and the absence of adequate supervision of sales practices).

Today, we are adopting rules that will provide greater clarity regarding the scope of the exemption provided by Section 3(a)(8). We believe our action is consistent with Congressional intent in that the definition will afford the disclosure, antifraud, and sales practice protections of the federal securities laws to purchasers of indexed annuities who are more likely than not to receive payments that vary in accordance with the performance of a security. In addition, the rules will provide relief from Exchange Act reporting obligations to the insurers that issue these indexed annuities and certain other securities that are regulated as insurance under state law. We base the Exchange Act exemption on two factors: first, the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of these activities and assets under state insurance law; and, second, the absence of trading interest in the securities.

A. Description of Indexed Annuities

An indexed annuity is a contract issued by a life insurance company that generally provides for accumulation of the purchaser's payments, followed by payment of the accumulated value to the purchaser either as a lump sum, upon death or withdrawal, or as a series of payments (an "annuity"). During the accumulation period, the insurer credits the purchaser with a return that is based on changes in a securities index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index. The insurer also guarantees a minimum value to the purchaser.[14] The specific features of indexed annuities vary from

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[14] FINRA Investor Alert, supra note 13; National Association of Insurance Commissioners, Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity-Indexed Annuities, at 9 (2007) ("NAIC Guide"); National Association for Fixed Annuities, White Paper on

product to product. Some key features, found in many indexed annuities, are as follows.

Computation of Index-Based Return

The purchaser's index-based return under an indexed annuity depends on the particular combination of features specified in the contract. Typically, an indexed annuity specifies all aspects of the formula for computing return in advance of the period for which return is to be credited, and the crediting period is generally at least one year long.[15] The rate of the index-based return is computed at the end of the crediting period, based on the actual performance of a specified securities index during that period, but the computation is performed pursuant to a mathematical formula that is guaranteed in advance of the crediting period. Common indexing features are described below.

- Index. Indexed annuities credit return based on the performance of a securities index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index. Some annuities permit the purchaser to select one or more indices from a specified group of indices.

- Determining Change in Index. There are several methods for determining the change in the relevant index over the crediting period.[16] For example, the "point-to-point" method compares the index level at two discrete points in time, such as

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Fixed Indexed Insurance Products Including 'Fixed Indexed Annuities' and Other Fixed Indexed Insurance Products, at 1 (2006), available at: http://www.nafa.us/index.php?act=attach&type=post&id=68 ("NAFA Whitepaper"); Jack Marrion, Index Annuities: Power and Protection, at 13 (2004) ("Marrion").

15 NAFA Whitepaper, supra note 14, at 13.

16 See FINRA Investor Alert, supra note 13; NAIC Guide, supra note 14, at 12-14; NAFA Whitepaper, supra note 14, at 9-10; Marrion, supra note 14, at 38-59.

the beginning and ending dates of the crediting period. Typically, in determining the amount of index change, dividends paid on securities underlying the index are not included. Indexed annuities typically do not apply negative changes in an index to contract value. Thus, if the change in index value is negative over the course of a crediting period, no deduction is taken from contract value nor is any index-based return credited.[17]

- Portion of Index Change to be Credited. The portion of the index change to be credited under an indexed annuity is typically determined through the application of caps, participation rates, spread deductions, or a combination of these features.[18] Some contracts "cap" the index-based returns that may be credited. For example, if the change in the index is 6%, and the contract has a 5% cap, 5% would be credited. A contract may establish a "participation rate," which is multiplied by index growth to determine the rate to be credited. If the change in the index is 6%, and a contract's participation rate is 75%, the rate credited would be 4.5% (75% of 6%). In addition, some indexed annuities may deduct a percentage, or spread, from the amount of gain in the index in determining return. If the change in the index is 6%, and a contract has a spread of 1%, the rate credited would be 5% (6% minus 1%).

Surrender Charges

Surrender charges are commonly deducted from withdrawals taken by a

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17 NAIC Guide, supra note 14, at 11; NAFA Whitepaper, supra note 14, at 5 and 9; Marrion, supra note 14, at 2.

18 See FINRA Investor Alert, supra note 13; NAIC Guide, supra note 14, at 10-11; NAFA Whitepaper, supra note 14, at 10; Marrion, supra note 14, at 38-59.

purchaser.[19] The maximum surrender charges, which may be as high as 15-20%,[20] are imposed on surrenders made during the early years of the contract and decline gradually to 0% at the end of a specified surrender charge period, which may be in excess of 15 years.[21] Imposition of a surrender charge may have the effect of reducing or eliminating any index-based return credited to the purchaser up to the time of a withdrawal. In addition, a surrender charge may result in a loss of principal, so that a purchaser who surrenders prior to the end of the surrender charge period may receive less than the original purchase payments.[22] Many indexed annuities permit purchasers to withdraw a portion of contract value each year, typically 10%, without payment of surrender charges.

Guaranteed Minimum Value

Indexed annuities generally provide a guaranteed minimum value, which serves as a floor on the amount paid upon withdrawal, as a death benefit, or in determining the amount of annuity payments. The guaranteed minimum value is typically a percentage of purchase payments, accumulated at a specified interest rate, and may not be lower than a floor established by applicable state insurance law. In the years immediately following their introduction, indexed annuities typically guaranteed 90% of purchase payments

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19 See FINRA Investor Alert, supra note 13; NAIC Guide, supra note 14, at 3-4 and 11; NAFA Whitepaper, supra note 14, at 7; Marrion, supra note 14, at 31.

20 The highest surrender charges are often associated with annuities in which the insurer credits a "bonus" equal to a percentage of purchase payments to the purchaser at the time of purchase. The surrender charge may serve, in part, to recapture the bonus.

21 See A Producer's Guide to Indexed Annuities 2007, LIFE INSURANCE SELLING (June 2007), available at: http://www.lifeinsuranceselling.com/Media/MediaManager/0607_IASurvey_1.pdf; Equity Indexed Annuities, ANNUITYADVANTAGE, available at: http://datafeeds.annuityratewatch.com/annuityadvantage/fixed-indexed-accounts.htm.

22 FINRA Investor Alert, supra note 13; Marrion, supra note 14, at 31.

accumulated at 3% annual interest.[23] More recently, however, following changes in state insurance laws,[24] indexed annuities typically provide that the guaranteed minimum value is equal to at least 87.5% of purchase payments, accumulated at annual interest rate of between 1% and 3%.[25] Assuming a guarantee of 87.5% of purchase payments, accumulated at 1% interest compounded annually, it would take approximately 13 years for a purchaser's guaranteed minimum value to be 100% of purchase payments.

Registration

Insurers typically have concluded that the indexed annuities they issue are not securities. As a result, virtually all indexed annuities have been issued without registration under the Securities Act.[26]

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23 1997 Concept Release, supra note 7 (concept release requesting comments on structure of equity indexed insurance products, the manner in which they are marketed, and other matters the Commission should consider in addressing federal securities law issues raised by these products). See also Letter from American Academy of Actuaries (Jan. 5, 1998); Letter from Aid Association for Lutherans (Nov. 19, 1997) (comment letters in response to 1997 Concept Release). The comment letters on the 1997 Concept Release are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC (File No. S7-22-97). Those comment letters that were transmitted electronically to the Commission are also available on the Commission's Web site at http://www.sec.gov/rules/concept/s72297.shtml.

24 See, e.g., CAL. INS. CODE § 10168.25 (West 2007) & IOWA CODE § 508.38 (2008) (current requirements, providing for guarantee based on 87.5% of purchase payments accumulated at minimum of 1% annual interest); CAL. INS. CODE § 10168.2 (West 2003) & IOWA CODE § 508.38 (2002) (former requirements, providing for guarantee for single premium annuities based on 90% of premium accumulated at minimum of 3% annual interest).

25 NAFA Whitepaper, supra note 14, at 6.

26 In a few instances, insurers have registered indexed annuities as securities as a result of particular features, such as the absence of any guaranteed interest rate or the absence of a guaranteed minimum value. See, e.g., Pre-Effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File No. 333-132399) (filed Feb. 7, 2007); Pre-Effective Amendment No. 1 to Registration Statement on Form S-3 of Allstate Life Insurance Company (File No. 333-105331) (filed May 16, 2003);

B. Section 3(a)(8) Exemption

Section 3(a)(8) of the Securities Act provides an exemption for any "annuity contract" or "optional annuity contract" issued by a corporation that is subject to the supervision of the insurance commissioner, bank commissioner, or similar state regulatory authority.[27] The exemption, however, is not available to all contracts that are considered annuities under state insurance law. For example, variable annuities, which pass through to the purchaser the investment performance of a pool of assets, are not exempt annuity contracts.

The U.S. Supreme Court has addressed the insurance exemption on two occasions.[28] Under these cases, factors that are important to a determination of an annuity's status under Section 3(a)(8) include (1) the allocation of investment risk between insurer and purchaser, and (2) the manner in which the annuity is marketed.

With regard to investment risk, beginning with SEC v. Variable Annuity Life Ins. Co. ("VALIC"),[29] the Court has considered whether the risk is borne by the purchaser (tending to indicate that the product is not an exempt "annuity contract") or by the insurer

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Initial Registration Statement on Form S-2 of Golden American Life Insurance Company (File No. 333-104547) (filed Apr. 15, 2003).

27 The Commission has previously stated its view that Congress intended any insurance contract falling within Section 3(a)(8) to be excluded from all provisions of the Securities Act notwithstanding the language of the Act indicating that Section 3(a)(8) is an exemption from the registration but not the antifraud provisions. Securities Act Release No. 6558 (Nov. 21, 1984) [49 FR 46750, 46753 (Nov. 28, 1984)]. See also Tcherepnin v. Knight, 389 U.S. 332, 342 n.30 (1967) (Congress specifically stated that "insurance policies are not to be regarded as securities subject to the provisions of the [Securities] act," (quoting H.R. Rep. 85, 73d Cong., 1st Sess. 15 (1933)).

28 VALIC, supra note 8, 359 U.S. 65; United Benefit, supra note 8, 387 U.S. 202.

29 VALIC, supra note 8, 359 U.S. at 71-73.

(tending to indicate that the product falls within the Section 3(a)(8) exemption). In VALIC, the Court determined that variable annuities, under which payments varied with the performance of particular investments and which provided no guarantee of fixed income, were not entitled to the Section 3(a)(8) exemption. In SEC v. United Benefit Life Ins. Co. ("United Benefit"),[30] the Court extended the VALIC reasoning, finding that a contract that provides for some assumption of investment risk by the insurer may nonetheless not be entitled to the Section 3(a)(8) exemption. The United Benefit insurer guaranteed that the cash value of its variable annuity contract would never be less than 50% of purchase payments made and that, after ten years, the value would be no less than 100% of payments. The Court determined that this contract, under which the insurer did assume some investment risk through minimum guarantees, was not an "annuity contract" under the federal securities laws. In making this determination, the Court concluded that "the assumption of an investment risk cannot by itself create an insurance provision under the federal definition" and distinguished a "contract which to some degree is insured" from a "contract of insurance."[31]

In analyzing investment risk, Justice Brennan's concurring opinion in VALIC applied a functional analysis to determine whether a new form of investment arrangement that emerges and is labeled "annuity" by its promoters is the sort of arrangement that Congress was willing to leave exclusively to the state insurance commissioners. In that inquiry, the purposes of the federal securities laws and state insurance laws are important. Justice Brennan noted, in particular, that the emphasis in the Securities Act is on

[30] United Benefit, supra note 8, 387 U.S. at 211.

[31] Id. at 211.

disclosure and that the philosophy of the Act is that "full disclosure of the details of the enterprise in which the investor is to put his money should be made so that he can intelligently appraise the risks involved."[32] We agree with the concurring opinion's analysis. Where an investor's investment in an annuity is sufficiently protected by the insurer, state insurance law regulation of insurer solvency and the adequacy of reserves are relevant. Where the investor's investment is not sufficiently protected, the disclosure protections of the Securities Act assume importance.

Marketing is another significant factor in determining whether a state-regulated insurance contract is entitled to the Securities Act "annuity contract" exemption. In United Benefit, the U.S. Supreme Court, in holding an annuity to be outside the scope of Section 3(a)(8), found significant the fact that the contract was "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management."[33] Under these circumstances, the Court concluded "it is not inappropriate that promoters' offerings be judged as being what they were represented to be."[34]

In 1986, given the proliferation of annuity contracts commonly known as "guaranteed investment contracts," the Commission adopted rule 151 under the Securities Act to establish a "safe harbor" for certain annuity contracts that are not deemed subject

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32 VALIC, supra note 8, 359 U.S. at 77.

33 United Benefit, supra note 8, 387 U.S. at 211.

34 Id. at 211 (quoting SEC v. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943)). For other cases applying a marketing test, see Berent v. Kemper Corp., 780 F. Supp. 431 (E.D. Mich. 1991), aff'd, 973 F. 2d 1291 (6th Cir. 1992); Associates in Adolescent Psychiatry v. Home Life Ins. Co., 729 F.Supp. 1162 (N.D. Ill. 1989), aff'd, 941 F.2d 561 (7th Cir. 1991); and Grainger v. State Security Life Ins. Co., 547 F.2d 303 (5th Cir. 1977).

to the federal securities laws and are entitled to rely on Section 3(a)(8) of the Securities Act.[35] Under rule 151, an annuity contract issued by a state-regulated insurance company is deemed to be within Section 3(a)(8) of the Securities Act if (1) the insurer assumes the investment risk under the contract in the manner prescribed in the rule; and (2) the contract is not marketed primarily as an investment.[36] Rule 151 essentially codifies the tests the courts have used to determine whether an annuity contract is entitled to the Section 3(a)(8) exemption, but adds greater specificity with respect to the investment risk test. Under rule 151, an insurer is deemed to assume the investment risk under an annuity contract if, among other things,

(1) the insurer, for the life of the contract,

  (a) guarantees the principal amount of purchase payments and credited interest, less any deduction for sales, administrative, or other expenses or charges; and

  (b) credits a specified interest rate that is at least equal to the minimum rate required by applicable state law; and

(2) the insurer guarantees that the rate of any interest to be credited in excess of the guaranteed minimum rate described in paragraph 1(b) will not be

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35 17 CFR 230.151; Securities Act Release No. 6645 (May 29, 1986) [51 FR 20254 (June 4, 1986)]. A guaranteed investment contract is a deferred annuity contract under which the insurer pays interest on the purchaser's payments at a guaranteed rate for the term of the contract. In some cases, the insurer also pays discretionary interest in excess of the guaranteed rate.

36 17 CFR 230.151(a).

modified more frequently than once per year.[37]

Indexed annuities are not entitled to rely on the safe harbor of rule 151 because they fail to satisfy the requirement that the insurer guarantee that the rate of any interest to be credited in excess of the guaranteed minimum rate will not be modified more frequently than once per year.[38]

III. DISCUSSION OF THE AMENDMENTS

The Commission has determined that providing greater clarity with regard to the status of indexed annuities under the federal securities laws will enhance investor protection, as well as provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. We are adopting a new definition of "annuity contract" that, on a prospective basis, defines a class of indexed annuities that are outside the scope of Section 3(a)(8). With respect to these annuities, investors will be entitled to all the protections of the federal securities laws, including full and fair disclosure and antifraud and sales practice protections. We are also adopting a

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37 17 CFR 230.151(b) and (c). In addition, the value of the contract may not vary according to the investment experience of a separate account.

38 Some indexed annuities also may fail other aspects of the safe harbor test.

In adopting rule 151, the Commission declined to extend the safe harbor to excess interest rates that are computed pursuant to an indexing formula that is guaranteed for one year. Rather, the Commission determined that it would be appropriate to permit insurers to make limited use of index features, provided that the insurer specifies an index to which it would refer, no more often than annually, to determine the excess interest rate that it would guarantee for the next 12-month or longer period. For example, an insurer would meet this test if it established an "excess" interest rate of 5% by reference to the past performance of an external index and then guaranteed to pay 5% interest for the coming year. Securities Act Release No. 6645, supra note 35, 51 FR at 20260. The Commission specifically expressed concern that index feature contracts that adjust the rate of return actually credited on a more frequent basis operate less like a traditional annuity and more like a security and that they shift to the purchaser all of the investment risk regarding fluctuations in that rate. See infra note 71 and accompanying text.

new exemption under the Exchange Act that applies to insurance companies that issue indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law. We believe that this exemption is necessary or appropriate in the public interest and consistent with the protection of investors because of the presence of state oversight of insurance company financial condition and the absence of trading interest in these securities.

A. Definition of Annuity Contract

The Commission is adopting new rule 151A, which defines a class of indexed annuities that are not "annuity contracts" or "optional annuity contracts"[39] for purposes of Section 3(a)(8) of the Securities Act. Although we recognize that these instruments are issued by insurance companies and are treated as annuities under state law, these facts are not conclusive for purposes of the analysis under the federal securities laws.

1. Analysis

"Insurance" and "Annuity": Federal Terms under the Federal Securities Laws

Our analysis begins with the well-settled conclusion that the terms "insurance" and "annuity contract" as used in the Securities Act are "federal terms," the meanings of which are a "federal question" under the federal securities laws.[40] The Securities Act

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[39] An "optional annuity contract" is a deferred annuity. See United Benefit, supra note 8, 387 U.S. at 204. In a deferred annuity, annuitization begins at a date in the future, after assets in the contract have accumulated over a period of time (normally many years). In contrast, in an immediate annuity, the insurer begins making annuity payments shortly after the purchase payment is made, i.e., within one year. See Kenneth Black, Jr., and Harold D. Skipper, Jr., Life and Health Insurance, at 164 (2000).

[40] See VALIC, supra note 8, 359 U.S. at 69. Although the McCarran-Ferguson Act, 15 U.S.C. 1012(b), provides that "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance," the United States Supreme Court has stated that the question common to both the federal securities laws and the McCarran-Ferguson Act is whether

does not provide a definition of either term, and we have not previously provided a definition that applies to indexed annuities.[41] Moreover, indexed annuities did not exist and were not contemplated by Congress when it enacted the insurance exemption.

We therefore analyze indexed annuities under the facts and circumstances factors articulated by the U.S. Supreme Court in VALIC and United Benefit. In particular, we focus on whether these instruments are "the sort of investment form that Congress was . . . willing to leave exclusively to the State Insurance Commissioners" and whether they necessitate the "regulatory and protective purposes" of the Securities Act.[42]

Type of Investment

We believe that the indexed annuities that will be included in our definition are not the sort of investment that Congress contemplated leaving exclusively to state

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the instruments are contracts of insurance. See VALIC, supra note 8. Thus, where a contract is not an "annuity contract" or "optional annuity contract," which we have concluded is the case with respect to certain indexed annuities, we do not believe that such contract is "insurance" for purposes of the McCarran-Ferguson Act.

41 The last time the Commission formally addressed indexed annuities was in 1997. At that time, the Commission issued a concept release requesting public comment regarding indexed insurance contracts. The concept release stated that "depending on the mix of features . . . [an indexed insurance contract] may or may not be entitled to exemption from registration under the Securities Act" and that the Commission was "considering the status of [indexed annuities and other indexed insurance contracts] under the federal securities laws." See 1997 Concept Release, supra note 7, at 4-5.

The Commission has previously adopted a safe harbor for certain annuity contracts that are entitled to rely on Section 3(a)(8) of the Securities Act. However, as discussed in Part II.B., indexed annuities are not entitled to rely on the safe harbor.

42 See VALIC, supra note 8, 359 U.S. at 75 (Brennan, J., concurring) (". . . if a brand-new form of investment arrangement emerges which is labeled 'insurance' or 'annuity' by its promoters, the functional distinction that Congress set up in 1933 and 1940 must be examined to test whether the contract falls within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners. In that inquiry, an analysis of the regulatory and protective purposes of the Federal Acts and of state insurance regulation as it then existed becomes relevant.").

insurance regulation. According to the U.S. Supreme Court, Congress intended to include in the insurance exemption only those policies and contracts that include a "true underwriting of risks" and "investment risk-taking" by the insurer.[43] Moreover, the level of risk assumption necessary for a contract to be "insurance" under the Securities Act must be meaningful – the assumption of an investment risk does not "by itself create an insurance provision under the federal definition."[44]

The annuities that "traditionally and customarily" were offered at the time Congress enacted the insurance exemption were fixed annuities that typically involved no investment risk to the purchaser.[45] These contracts offered the purchaser "specified and definite amounts beginning with a certain year of his or her life," and the "standards for investments of funds" by the insurer under these contracts were "conservative."[46] Moreover, these types of annuity contracts were part of a "concept which had taken on its coloration and meaning largely from state law, from state practice, from state usage."[47] Thus, Congress exempted these instruments from the requirements of the federal securities laws because they were a "form of 'investment'. . . which did not present very

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43 Id. at 71-73.

44 See United Benefit, supra note 8, 387 U.S. at 211 ("[T]he assumption of investment risk cannot by itself create an insurance provision. . . . The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.").

45 See VALIC, supra note 8, 359 U.S. at 69.

46 Id. ("While all the States regulate 'annuities' under their 'insurance' laws, traditionally and customarily they have been fixed annuities, offering the annuitant specified and definite amounts beginning with a certain year of his or her life. The standards for investment of funds underlying these annuities have been conservative.").

47 Id. ("Congress was legislating concerning a concept which had taken on its coloration and meaning largely from state law, from state practice, from state usage.").

squarely the problems that [the federal securities laws] were devised to deal with," and were "subject to a form of state regulation of a sort which made the federal regulation even less relevant."[48]

In contrast, when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the amounts guaranteed under the contract, the purchaser assumes substantially different risks and benefits. Notably, at the time that such a contract is purchased, the risk for the unknown, unspecified, and fluctuating securities-linked portion of the return is primarily assumed by the purchaser.

By purchasing this type of indexed annuity, the purchaser assumes the risk of an uncertain and fluctuating financial instrument, in exchange for participation in future securities-linked returns. The value of such an indexed annuity reflects the benefits and risks inherent in the securities market, and the contract's value depends upon the trajectory of that same market. Thus, the purchaser obtains an instrument that, by its very terms, depends on market volatility and risk.

Such indexed annuity contracts provide some protection against the risk of loss, but these provisions do not, "by [themselves,] create an insurance provision under the federal definition."[49] Rather, these provisions reduce – but do not eliminate – a purchaser's exposure to investment risk under the contract. These contracts may to some degree be insured, but that degree may be too small to make the indexed annuity a

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48 Id. at 75 (Brennan, J., concurring).

49 See United Benefit, supra note 8, 387 U.S. at 211 (finding that while a "guarantee of cash value" provided by an insurer to purchasers of a deferred annuity plan reduced "substantially the investment risk of the contract holder, the assumption of investment risk cannot by itself create an insurance provision under the federal definition.").

contract of insurance.[50]

Thus, the protections provided by indexed annuities may not adequately transfer investment risk from the purchaser to the insurer when amounts payable by an insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract. Purchasers of these annuities assume the investment risk for investments that are more likely than not to fluctuate and move with the securities markets. The value of the purchaser's investment is more likely than not to depend on movements in the underlying securities index. The protections offered in these indexed annuities may give the instruments an aspect of insurance, but we do not believe that these protections are substantial enough.[51]

Need for the Regulatory Protections of the Federal Securities Acts

We also analyze indexed annuities to determine whether they implicate the regulatory and protective purposes of the federal securities laws. Based on that analysis, we believe that the indexed annuities that are included in the definition that we are adopting present many of the concerns that Congress intended the federal securities laws to address.

Indexed annuities are similar in many ways to mutual funds, variable annuities, and other securities. Although these contracts contain certain features that are typical of

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50 Id. at 211 ("The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.").

51 See VALIC, supra note 8, 359 U.S. at 71 (finding that although the insurer's assumption of a traditional insurance risk gives variable annuities an "aspect of insurance," this is "apparent, not real; superficial, not substantial.").

insurance contracts,[52] they also may contain "to a very substantial degree elements of investment contracts."[53] Indexed annuities are attractive to purchasers precisely because they offer participation in the securities markets. However, indexed annuities historically have not been registered with us as securities. Insurers have treated these annuities as subject only to state insurance laws.

There is a strong federal interest in providing investors with disclosure, antifraud, and sales practice protections when they are purchasing annuities that are likely to expose them to market volatility and risk. We believe that individuals who purchase indexed annuities that are more likely than not to provide payments that vary with the performance of securities are exposed to significant investment risks. They are confronted with many of the same risks and benefits that other securities investors are confronted with when making investment decisions. Moreover, they are more likely than not to experience market volatility because they are more likely than not to receive payments that vary with the performance of securities.

We believe that the regulatory objectives that Congress was attempting to achieve when it enacted the Securities Act are present when the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the guaranteed amounts. Therefore, we are adopting a rule that will define such contracts as falling

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52 The presence of protection against loss does not, in itself, transform a security into an insurance or annuity contract. Like indexed annuities, variable annuities typically provide some protection against the risk of loss, but are registered as securities. Historically, variable annuity contracts have typically provided a minimum death benefit at least equal to the greater of contract value or purchase payments less any withdrawals. More recently, many contracts have offered benefits that protect against downside market risk during the purchaser's lifetime.

53 VALIC, supra note 8, 359 U.S. at 91 (Brennan, J., concurring).

outside the insurance exemption.

2. Commenters' Concerns Regarding Commission's Analysis

Many commenters raised significant concerns regarding the Commission's analysis of indexed annuities under Section 3(a)(8). Commenters argued that the Commission's analysis is inconsistent with applicable legal precedent, particularly the VALIC and United Benefit cases. Specifically, the commenters argued that the purchaser of an indexed annuity does not assume investment risk in the sense contemplated by applicable precedent, that the Commission failed to take into account the investment risk assumed by the insurer, and that the Commission's analysis ignored the factors of marketing and mortality risk which have been articulated in applicable precedents. In addition, commenters questioned the need for federal securities regulation of indexed annuities, arguing that there is no evidence of widespread sales practice abuse in the indexed annuity marketplace, that state insurance regulators are effective in protecting purchasers of indexed annuities, and that the Commission's disclosure requirements would not result in enhanced information flow to purchasers of indexed annuities. We disagree with each of these assertions for the reasons outlined below.

Commission's Analysis is Consistent with Applicable Precedents

We disagree with commenters who argued that the Commission's analysis is inconsistent with applicable legal precedents, particularly the VALIC and United Benefit cases.[54] These commenters asserted, first, that because of guarantees of principal and

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54 See, e.g., Letter of Advantage Group Associates, Inc. (Nov. 16, 2008) ("Advantage Group Letter"); Letter of Allianz Life Insurance Company of North America (Sept. 10, 2008) ("Allianz Letter"); Letter of American Academy of Actuaries (Sept. 10, 2008) ("Academy Letter"); Letter of American Academy of Actuaries (Nov. 17, 2008) ("Second Academy Letter"); Letter of American Equity Investment Life Holding

minimum interest, the purchaser of an indexed annuity does not assume investment risk in the sense contemplated by applicable precedent which, in their view, is the risk of loss of principal. Second, the commenters argued that the Commission's analysis failed to take into account the investment risk assumed by the insurer, including the risk associated with guaranteeing principal and a minimum interest rate and with guaranteeing in advance the formula for determining index-linked return. Third, commenters argued that the Commission's analysis is inconsistent with precedent because it does not take into account the manner in which indexed annuities are marketed.[55] Fourth, commenters

Company (Sept. 10, 2008) ("American Equity Letter"); Letter of American National Insurance Company (Sept. 10. 2008) ("American National Letter"); Letter of Aviva USA Corporation (Sept. 10, 2008) ("Aviva Letter"); Letter of Aviva USA Corporation (Nov. 17, 2008) ("Second Aviva Letter"); Letter of Coalition for Indexed Products (Sept. 10, 2008) ("Coalition Letter"); Letter of Committee of Annuity Insurers regarding proposed rule 151A (Sept. 10, 2008) ("CAI 151A Letter"); Letter of Lafayette Life Insurance Company (Sept. 10, 2008) ("Lafayette Letter"); Letter of Maryland Insurance Administration (Sept. 9, 2008) ("Maryland Letter"); Letter of the Officers of the National Association of Insurance Commissioners (Sept. 10, 2008) ("NAIC Officer Letter"); Letter of National Association for Fixed Annuities (Sept. 10, 2008) ("NAFA Letter"); Letter of National Association of Insurance and Financial Advisers (Sept. 10, 2008) ("NAIFA Letter"); Letter of National Conference of Insurance Legislators (Nov. 25, 2008) ("NCOIL Letter"); Letter of National Western Life Insurance Company (Sept. 10, 2008) ("National Western Letter"); Letter of Old Mutual Financial Network (Sept. 10, 2008) ("Old Mutual Letter"); Letter of Sammons Annuity Group (Sept. 10, 2008) ("Sammons Letter"); Letter of Transamerica Life Insurance Company (Sept. 10, 2008) ("Transamerica Letter"); Letter of Transamerica Life Insurance Company (Nov. 17, 2008) ("Second Transamerica Letter").

Other commenters, however, supported the Commission's interpretation of Section 3(a)(8) and applicable legal precedents. See, e.g., ICI Letter, supra note 7; Letter of K&L Gates on behalf of AXA Equitable Life Insurance Company, Hartford Financial Services Group, Inc., Massachusetts Mutual Life Insurance Company, MetLife, Inc., and New York Life Insurance Company (Oct. 7, 2008) ("K&L Gates Letter").

55 See, e.g., Coalition Letter, supra note 54; Letter of The Hartford Financial Services Group, Inc. (Sept. 10, 2008) ("Hartford Letter"); NAFA Letter, supra note 54.

faulted the Commission's analysis for ignoring mortality risk.[56]

Our investment risk analysis is an application of the Court's reasoning in the VALIC and United Benefit cases, and rule 151A applies that analysis with a specific test to determine the status under the federal securities laws of indexed annuities. Indexed annuities are a relatively new product and are different from the securities considered in those cases. These very differences have resulted in the uncertain legal status of indexed annuities from their introduction in the mid-1990s. Like the contract at issue in United Benefit, indexed annuities present a new case that requires us to determine whether "a contract which to some degree is insured" constitutes a "contract of insurance" for purposes of the federal securities laws.[57] Indexed annuities offer to purchasers a financial instrument with uncertain and fluctuating returns that are, in part, securities-linked. We believe that whether such an instrument is a security hinges on the likelihood that the purchaser's return will, in fact, be based on the returns of a securities index. In cases where the amounts payable by an insurer under an indexed annuity contract are more likely than not to exceed the amounts guaranteed under the contract, the amount the purchaser receives will be dependent on market returns and will vary because of investment risk. In such a case, we have concluded that, on a prospective basis, the indexed annuity is not entitled to rely on the Section 3(a)(8) exemption. Though the contract may to some degree be insured, it is not a contract of insurance because of the substantial investment risk assumed by the purchaser.

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56 See, e.g., CAI 151A Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54.

57 See United Benefit, supra note 8, 387 U.S. at 211 ("The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized.").

A number of commenters equated investment risk with the risk of loss of principal for purposes of analysis under Section 3(a)(8) and argued that, because of guarantees of principal and minimum interest, the purchaser of an indexed annuity does not assume investment risk. We disagree. While the potential for loss of principal was important in the VALIC and United Benefit cases and helpful in analyzing the particular products at issue in those cases, it is by no means the only type of investment risk. Defining risk only as the possibility of principal loss or an approximate equivalent, as suggested by commenters, fails to account for important forms of risk and leads to conclusions inconsistent with the contemporary understanding of investment risk. Such a limited definition of risk would thus be incomplete.

One widely accepted definition of "risk" in financial instruments is the degree to which returns deviate from their statistical expectation.[58] Accordingly, even investments guaranteeing a positive minimum return over long investment horizons, such as indexed annuities, may have returns that meaningfully and unpredictably deviate from the expected return and therefore have investment risk under this definition.

For example, accepting the definition of risk suggested by commenters as a complete characterization of risk would lead to the conclusion that any two assets that both guarantee return of principal equally have no risk. However, we believe that the market would generally view an asset where the future payoff of the amount over the guaranteed principal return is uncertain to be more risky than a zero-coupon U.S. government bond maturing at the same date, which also guarantees principal return but

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58 Zvi Bodie, Alex Kane and Alan J. Marcus, Investments, at 143 (2005) ("The standard deviation of the rate of return is a measure of risk.").

has a nearly certain future payoff. Defining risk as the potential for loss of principal, or principal plus some minimal amount, misses important aspects of risk as commonly understood. While U.S. government bonds are commonly accepted as the standard benchmark of a nominally risk-free rate of return because their returns are considered to be nearly certain at specific horizons, the definition suggested by commenters fails to distinguish between these risk-free assets and assets that are protected against principal loss but that have uncertain payoffs above the guaranteed principal return.[59]

Additionally, under the definition of risk suggested by the commenters, most assets with positive expected returns would appear to have little to no risk over long horizons. As an example, using reasonable assumptions it can be estimated that a value-weighted portfolio of New York Stock Exchange ("NYSE") stocks has approximately a 6% chance of returning less than principal in 10 years, and approximately a 1% chance of returning less than principal in 20 years.[60] Despite these relatively low probabilities of losing principal over long periods of time, we believe that it is generally understood that market participants, even those with long investment horizons, bear meaningful investment risk when investing in such a diversified portfolio of stocks. Indeed, investors generally consider modest long-term returns, even if greater than 0% or some minimal rate, to be undesirable outcomes when the expected return was substantially greater. We

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59 Zvi Bodie, Alex Kane and Alan J. Marcus, Investments, at 144 (2005).

60 Our Office of Economic Analysis conducted a simulation, in which annual returns from the Center for Research in Security Prices ("CRSP") capitalization-weighted NYSE index, annually rebalanced, from 1926 through 2007, are drawn randomly and aggregated (a bootstrap procedure). This procedure replicates the observed mean, standard deviation, skewness, kurtosis, and other observed moments of returns, but assumes that returns are intertemporally independent. Realized 10-year returns in this period are negative 4% of the time, and there have been no 20-year negative returns.

therefore believe that the commenters' suggestion that such a portfolio is without risk is at odds both with the commonly accepted meaning of the term as well as with the definition of risk generally accepted by financial economists.

The purchaser of an indexed annuity assumes investment risk because his or her return is not known in advance and therefore varies from its expected value. When the amounts payable to the purchaser are more likely than not to exceed the guaranteed amounts, the investment risk assumed by the purchaser of an indexed annuity is substantial, and we believe that the contract should not be treated as an "annuity contract" for purposes of the federal securities laws. We also note that indexed annuities are not, in fact, without the risk of principal loss. An indexed annuity purchaser who surrenders the contract during the surrender charge period, which for some indexed annuities may be in excess of 15 years, may receive less than his or her original principal. Unlike a purchaser of a fixed annuity, a purchaser of an indexed annuity is dependent on favorable securities market returns to overcome the impact of the surrender charge and create a positive return rather than a loss.

We also disagree with commenters who argued that the Commission's analysis failed to take into account the investment risk assumed by the insurer, including the risk associated with guaranteeing principal and a minimum interest rate and with guaranteeing in advance the formula for determining securities-linked return. We agree with commenters that, in analyzing the status of indexed annuities under the federal securities laws, it is important to take into account the relative significance of the risks assumed by the insurer and the purchaser. In our analysis, the Commission does not ignore the risk assumed by the insurer as the commenters suggest. In fact, the rule, as proposed and adopted, specifically contemplates different outcomes based on the relative risks assumed by the insurer and purchaser. When the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed, the contract loses the insurance exemption under rule 151A.

Unlike a traditional fixed annuity where the investment risk for the contract is assumed by the insurer, or a traditional variable annuity where the investment risk for the contract is assumed by the purchaser, the very mixed nature of indexed annuities led the Commission to carefully consider the relative risks assumed by both parties to the contract. The fact that the rule does not define all indexed annuities as outside Section 3(a)(8), but rather sets forth a test for analyzing these contracts, reflects the Commission's understanding that the status of these contracts under the federal securities laws hinges on the allocation of risk between both the insurer and the purchaser. Specifically, the rule recognizes that where the insurer is more likely than not to pay an amount that is fixed and guaranteed by the insurer, significant investment risks are assumed by the insurer and such a contract may therefore be entitled to the Section 3(a)(8) exemption. Conversely, where the purchaser is more likely than not to receive an amount that is variable and dependent on fluctuations and movements in the securities markets, rule 151A recognizes the significant investment risks assumed by the purchaser and specifies that such a contract would not be considered to fall within Section 3(a)(8). Moreover, both the guaranteed interest rate within an indexed annuity and the formula for crediting interest are typically reset on an annual basis. This provides insurers with a number of ways to reduce or eliminate their investment risks, including hedging market risk through the purchase of options or other derivatives and adjusting guarantees downwards in subsequent years to offset losses in earlier years of a contract. For purposes of analysis under Section 3(a)(8), we do not consider these investment risks to be comparable to those of the indexed annuity purchaser, who bears the risk of a fluctuating and uncertain return based on the performance of a securities index.

Some commenters argued that the Commission's investment risk analysis is inconsistent with its own position in the Brief for the United States as Amicus Curiae in Variable Annuity Life Insurance Company, et al. v. Otto ("VALIC v. Otto").[61] That matter involved an annuity in which the insurer guaranteed principal and a minimum rate of interest and also could, in its discretion, credit excess interest above the guaranteed rate. The Commission argued that by guaranteeing principal and an adequate fixed rate of interest, and guaranteeing payment of all discretionary excess interest declared under the contract, the insurer assumed sufficient investment risk under the contract for it to fall within Section 3(a)(8), notwithstanding the assumption of the risk by the contract owner that the excess interest rate could be reduced or eliminated at the insurer's discretion.

We agree with commenters that our analysis is different from the position taken by the Commission in the VALIC v. Otto brief. However, this results from the fact that indexed annuity contracts are different from the contracts considered in VALIC v. Otto. Unlike the contracts in that case, which were annuity contracts that provided for wholly discretionary payment of excess interest, indexed annuities contractually specify that excess interest will be calculated by reference to a securities index. As a result, the

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[61] Brief for the United States as Amicus Curiae on Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit, VALIC v. Otto, No. 87-600, October Term, 1987. See, e.g., Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; Coalition Letter, supra note 54; NAFA Letter, supra note 54.

purchaser of an indexed annuity is contractually bound to assume the investment risk for the fluctuations and movements in the underlying securities index. The contract in VALIC v. Otto did not impose this securities-linked investment risk on the purchaser. Moreover, we note that the Supreme Court did not grant certiorari in VALIC v. Otto. The final opinion in the case was rendered by the Seventh Circuit and was to the effect that, as a result of the insurer's discretion to declare excess interest under the contract, the insurer's guarantees were not sufficient to exempt the contract from the federal securities laws. Thus, the Commission's position in the case was not adopted by either the Seventh Circuit or the Supreme Court. We believe that the position articulated in the VALIC v. Otto brief is not relevant in the context of indexed annuities and, to the extent that the brief may imply otherwise, the position taken in the brief does not reflect the Commission's current position. Where the contractual return paid by an insurer under an annuity contract is retroactively determined based, in whole or in part, on the returns of a security in a prior period, we do not believe that fact – and the investment risk that it entails – can be ignored in determining whether the contract is an "annuity contract" that is entitled to the Section 3(a)(8) exemption.

Though rule 151A does not explicitly incorporate a marketing factor, we disagree with commenters who argued that the Commission's analysis is inconsistent with precedent, because it does not take into account the manner in which indexed annuities are marketed.[62] The very nature of an indexed annuity, where return is contractually linked to the return on a securities index, is, to a very substantial extent, designed to

62 See, e.g., Coalition Letter, supra note 54; NAFA Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54.

appeal to purchasers on the prospect of investment growth.[63] This is particularly true in the case of indexed annuities that rule 151A defines as not "annuity contracts" -- i.e., indexed annuities where the purchaser is more likely than not to receive securities-linked returns. It would be inconsistent with the character of such an indexed annuity, and potentially misleading, to market the annuity without placing significant emphasis on the securities-linked return and the related risks. We disagree with commenters who argued that purchasers do not buy indexed annuities on the basis of the prospect for investment growth, but rather on the basis of guarantees and stability of principal.[64] We agree with commenters that purchasers of indexed annuities, just like purchasers of variable annuities, have a blend of reasons for their purchase, including product guarantees and tax deferral.[65] However, we also believe that purchasers who are uninterested in the growth offered by securities-linked returns would opt for higher fixed returns in lieu of the lower fixed returns, coupled with the prospect of securities-linked growth, offered by indexed annuities. Indeed, data submitted by one indexed annuity issuer confirm that almost half (46.60%) of its 2008 indexed annuity purchasers identify the prospect for growth as a reason for their purchase.[66] Just as with variable annuities, the fact that

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63 See, e.g., K&L Gates Letter, supra note 54. But see Letter of National Western Life Insurance Company (Nov. 17, 2008) ("Second National Western Letter") (criticizing the K&L Gates position).

64 See, e.g., Allianz Letter, supra note 54; American Equity Letter, supra note 54; Coalition Letter, supra note 54.

65 See, e.g., Allianz Letter, supra note 54 (55.45% purchased indexed annuities because of guarantes and 54.88% because of tax deferral).

66 See Allianz Letter, supra note 54. But see Coalition Letter, supra note 54 (sampling by some indexed annuity issuers reveals that a large majority of purchasers acquire fixed annuities for stability of premiums). We are not able to ascertain from the statement in

indexed annuities appeal to purchasers for a variety of reasons does not detract from the significant appeal of securities-linked growth. Accordingly, we have concluded that, in light of the nature of indexed annuities, it is unnecessary to include a separate marketing factor within rule 151A. The Supreme Court did not address marketing in VALIC. Similarly, we have concluded that a separate marketing analysis is unnecessary in the case of indexed annuities that are addressed by rule 151A.

Nor do we agree with commenters who argued that the Commission's analysis departs from precedent in that it does not take into account mortality risk.[67] In both VALIC and United Benefit, the Supreme Court found the investment risk test to be determinative (together with the marketing test in the case of United Benefit) that an insurance contract was not entitled to the Section 3(a)(8) exemption. While the Commission has stated, and we continue to believe, that the presence or absence of assumption of mortality risk may be an appropriate factor to consider in a Section 3(a)(8) analysis,[68] we do not believe that it should be given undue weight in determining the status of a contract under the federal securities laws, where it is clear from the nature of the investment risk that the contract is not an "annuity contract" for securities law purposes. We have concluded that this is the case for an indexed annuity where the amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract.

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the Coalition Letter the degree to which purchasers identified growth as a goal as the letter addressed only stability of premiums.

67 See, e.g., CAI 151A Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54.

68 Securities Act Release No. 6645, supra note 35.

Some commenters criticized the Commission for failing to adequately address a federal district court decision, Malone v. Addison Ins. Marketing, Inc. ("Malone"),[69] where the court determined that a particular indexed annuity was entitled to rely on Section 3(a)(8).[70] We disagree with the Malone court's analysis of investment risk, which, we believe, understated the investment risk to the purchaser of an indexed annuity from the fluctuating and uncertain securities-linked return and therefore is inconsistent with applicable legal precedent. We also disagree with the court's interpretation of the Commission's rule 151 safe harbor, which does not apply to indexed annuities. As we discussed in the proposing release, in that case, the district court concluded that the contracts at issue fell within the Commission's rule 151 safe harbor notwithstanding the fact that they apparently did not meet the test articulated by the Commission in adopting rule 151, i.e., specifying an index that would be used to determine a rate that would remain in effect for at least one year.[71] Instead, the contracts appear to have guaranteed the index-based formula, but not, as required by rule 151, the actual rate of interest.

Need for Federal Securities Regulation

Some commenters agreed that federal securities regulation is needed with respect to indexed annuities.[72] Other commenters questioned the need for federal securities

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69 225 F.Supp. 2d 743 (W.D. Ky. 2002).

70 See, e.g., Coalition Letter, supra note 54; NAFA Letter, supra note 54; Sammons Letter, supra note 54.

71 See supra note 38.

72 See, e.g., Letter of Joseph P. Borg, Director, Alabama Securities Commission (Aug. 5, 2008) ("Alabama Letter"); Cornell Letter, supra note 7; Letter of Financial Planning Association (Sept. 10, 2008) ("FPA Letter); FINRA Letter, supra note 7; Hartford Letter,

regulation of indexed annuities, and we disagree with those commenters. These commenters argued, first, that there is no evidence of widespread sales practice abuse in the indexed annuity marketplace, which would suggest a need for federal securities regulation.[73] Second, commenters argued that state insurance regulators are effective in protecting purchasers of indexed annuities.[74] Third, commenters argued that the Commission's disclosure requirements would not result in enhanced information flow to purchasers of indexed annuities.[75]

We believe that the commenters who argued that regulation of indexed annuities under the federal securities laws is unnecessary because there is no evidence of widespread sales abuse misunderstand the exemption under Section 3(a)(8) of the Securities Act as well as our purpose in proposing, and now adopting, rule 151A. Some of these commenters cited data that they argued demonstrated that the incidence of abuse

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supra note 55; ICI Letter, supra note 7; Letter of Max Maxfield, Secretary of State, State of Wyoming (Sept. 9, 2008) ("Wyoming Letter").

73 See, e.g., American Equity Letter, supra note 54; Coalition Letter, supra note 54; Letter of FBL Financial Group (Sept. 8, 2008) ("FBL Letter"); Lafayette Letter, supra note 54; Maryland Letter, supra note 54; NAIFA Letter, supra note 54; Sammons Letter, supra note 54.

74 See, e.g., Allianz Letter, supra note 54; Academy Letter, supra note 54; Letter of American Bankers Insurance Association (Sept. 10, 2008) ("American Bankers Letter"); American Equity Letter, supra note 54; American National Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54; Letter of Connecticut Insurance Commissioner (Aug. 25, 2008) ("Connecticut Letter"); Letter of Iowa Insurance Commissioner (Sept. 10, 2008) ("Iowa Letter"); Maryland Letter, supra note 54; NAFA Letter, supra note 54; NAIC Officer Letter, supra note 54; NAIFA Letter, supra note 54; National Western Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54; Transamerica Letter, supra note 54.

75 See, e.g., Allianz Letter, supra note 54; Aviva Letter, supra note 54.

in the indexed annuity marketplace is low.[76] Some of these commenters argued that the proposing release failed to present persuasive evidence of sales practice abuse.[77]

A vital aspect of the Commission's mission is investor protection. As a result, reports of sales practice abuses surrounding a product, indexed annuities, whose status has long been unresolved under the federal securities laws, are a matter of grave concern to us. However, the presence or absence of sales practice abuses is irrelevant in determining whether an annuity contract is entitled to the exemption from federal securities regulation under Section 3(a)(8) of the Securities Act. Where an annuity contract is entitled to the Section 3(a)(8) exemption, the federal securities laws do not apply, and purchasers are not entitled to their protections, regardless of whether sales practice abuses may be pervasive. Where, however, an annuity contract is not entitled to the Section 3(a)(8) exemption, which we have concluded is the case with respect to certain indexed annuities, Congress intended that the federal securities laws apply, and purchasers are entitled to the disclosure and suitability protections under those laws without regard to whether there is a single documented incident of abuse.

This view is consistent with applicable precedent which makes clear that the necessity for federal regulation arises from the characteristics of the financial instrument

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[76] See, e.g., Advantage Group Letter, supra note 54; American Equity Letter, supra note 54; Maryland Letter, supra note 54; NAIFA Letter, supra note 54; Letter of Old Mutual Financial Network (Nov. 12, 2008) ("Second Old Mutual Letter"); Letter Type A ("Letter A"); Letter Type E ("Letter E"). "Letter Type" refers to a form letter submitted by multiple commenters, which is listed on the Commission's Web site (http://www.sec.gov/comments/s7-14-08/s71408.shtml) as a single comment, with a notation of the number of letters received by the Commission matching that form type.

[77] See, e.g., American Equity Letter, supra note 54; FBL Letter supra note 73; Maryland Letter, supra note 54; NAIFA Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54; Second National Western Letter, supra note 63.

itself. This has been the approach of the United States Supreme Court in the two leading precedents. In those cases, the Court made a realistic judgment about the point at which a contract between a purchaser and an insurance company tips from being the sole concern of state regulators of insurance to also become the concern of the federal securities laws.

The United Benefit Court observed that the products at issue in that case were "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management."[78] They were "pitched to the same consumer interest in growth through professionally managed investment," and, as a result, the Court concluded that it seemed "eminently fair that a purchaser of such a plan be afforded the same advantages of disclosure which inure to a mutual fund purchaser under Section 5 of the Securities Act."[79]

The United Benefit decision picked up and extended a theme previously discussed in Justice Brennan's concurring opinion in VALIC. Justice Brennan examined the differing nature of state regulation of insurance and federal regulation of the securities markets. He looked at the nature of the obligation the insurer assumed and its connection to the regulation of investment policy. He concluded that there came a point when the "contract between the investor and the organization no longer squares with the sort of contract in regard to which Congress in 1933 thought its 'disclosure' statute was unnecessary."[80]

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78 United Benefit, supra note 8, 387 U.S. at 211.

79 Id.

80 VALIC, supra note 8, 359 U.S. at 72.

It is precisely this realistic judgment about identifying the appropriate circumstances in which to apply the disclosure and other regulatory protections of the federal securities laws that rule 151A makes. That is why the rule adopts the principle that an indexed annuity providing for a combination of minimum guaranteed payments plus a potentially higher payment dependent on the performance of a securities index does not qualify for the insurance exclusion in Section 3(a)(8) when the amounts payable by the insurer under the contact are more likely than not to exceed the amounts guaranteed under the contract.

Our intent in adopting rule 151A is to clarify the status of indexed annuities under the federal securities laws, so that purchasers of these products receive the protections to which they are entitled by federal law and so that issuers and sellers of these products are not subject to uncertainty and litigation risk with respect to the laws that are applicable. We expect that clarity will enhance investor protection in the future, and indeed will help prevent future sales practice abuses, but rule 151A is not based on the perception that there are widespread sales abuses in the indexed annuity marketplace. Rather, the rule is intended to address an uncertain area of the law, which, because of the growth of the indexed annuity market and allegations of sales practice abuses, has become of pressing importance.

A number of commenters cited efforts by state insurance regulators to address disclosure and sales practice concerns with respect to indexed annuities as evidence that federal securities regulation is unnecessary and could result in duplicative or overlapping regulation.[81] Commenters argued that state regulation extends beyond overseeing solvency and adequacy of the insurers' reserves, and that it is also addressed to investor protection issues such as suitability and disclosure.[82] Commenters cited, in particular, the NAIC Suitability in Annuity Transactions Model Regulation,[83] which has been adopted in 35 states,[84] and its adoption by the majority of states as evidence that states are addressing suitability concerns in connection with indexed annuity sales.[85] Commenters also noted that a number of states have adopted the NAIC Annuity Disclosure Model Regulation,[86] which has been adopted in 22 states and which requires delivery of certain disclosure documents regarding indexed annuity contracts.[87] Commenters also cited the existence of state market conduct examinations, the use of state enforcement and

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81 See, e.g., Allianz Letter, supra note 54; American Bankers Letter, supra note 74; American Equity Letter, supra note 54; FBL Letter supra note 73; Maryland Letter, supra note 54; NAFA Letter, supra note 54; Letter of National Association of Health Underwriters (Sept. 10, 2008) ("Health Underwriters Letter"); National Western Letter, supra note 54; Letter of Vermont Department of Banking, Insurance, Securities and Health Care Administration (Nov. 17, 2008).

82 See, e.g., Allianz Letter, supra note 54; American Equity Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54; Maryland Letter, supra note 54; NAFA Letter, supra note 54; NAIFA Letter, supra note 54; National Western Letter, supra note 54; Old Mutual Letter, supra note 54; Sammons Letter, supra note 54.

83 NAIC SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION (Model 275-1) (2003).

84 National Association of Insurance Commissioners, Draft Model Summaries, available at: http://www.naic.org/committees_models.htm.

85 See, e.g., Letter A, supra note 76; American Bankers Letter, supra note 74; CAI 151A Letter, supra note 54; NAFA Letter, supra note 54; NAIC Officer Letter, supra note 54; NAIFA Letter, supra note 54.

86 NAIC ANNUITY DISCLOSURE MODEL REGULATION (Model 245-1) (1998).

87 See, e.g., Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; NAFA Letter, supra note 54; NAIC Officer Letter, supra note 54; NAIFA Letter, supra note 54.

investigative authority, and licensing and education requirements applicable to insurance agents who sell indexed annuities.[88]

Commenters described a number of recent and ongoing efforts by state insurance regulators. Some commenters cited efforts being undertaken by individual states. For example, commenters cited an Iowa regulation which recently became effective requiring that agents receive indexed product training approved by the Iowa Insurance Division before they can sell indexed annuity products.[89] In addition, commenters stated that Iowa has partnered with the American Council of Life Insurers ("ACLI") to operate a one-year pilot project with some ACLI members using templates developed for disclosure regarding indexed annuities, with the goal of assuring uniformity among insurers in the preparation of disclosure documents.[90] Commenters also noted recent efforts by state regulators addressed to annuities generally, such as the creation of NAIC working groups to review and consider possible improvements to the NAIC Suitability in Annuity Transactions Model Regulation and the NAIC Annuity Disclosure Model Regulation.[91]

We applaud the efforts in recent years of state insurance regulators to address sales practice complaints that have arisen with respect to indexed annuities, and it is not our intention to question the effectiveness of state regulation. Nonetheless, we do not believe that the states' regulatory efforts, no matter how strong, can substitute for our

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88 See, e.g., American Equity Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54; Maryland Letter, supra note 54; NAIC Officer Letter, supra note 54; NAFA Letter, supra note 54.

89 See, e.g., Aviva Letter, supra note 54; Iowa Letter, supra note 74; NAIC Officer Letter, supra note 54.

90 See, e.g., Iowa Letter, supra note 74; NAIC Officer Letter, supra note 54.

91 See, e.g., NAIC Officer Letter, supra note 54.

responsibility to identify securities covered by the federal securities laws and the protections Congress intended to apply. State insurance laws, enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws. Indeed, at least one state insurance regulator acknowledged the developmental nature of state efforts and the lack of uniformity in those efforts.[92] Where the purchaser of an indexed annuity assumes the investment risk of an instrument that fluctuates with the securities markets, and the contract therefore does not fall within the Section 3(a)(8) exemption, the application of state insurance regulation, no matter how effective, is not determinative as to whether the contract is subject to the federal securities laws.

Some commenters also cited voluntary measures taken by insurance companies, such as suitability reviews and the provision of plain English disclosures, as a reason why federal securities regulation of indexed annuities is unnecessary.[93] While these voluntary measures are commendable, they are not a substitute for the provisions of the federal securities laws that Congress mandated.

Finally, we note that some commenters argued that regulation of indexed annuities by the Commission would not enhance investor protection, in particular because

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92 See Voss Letter, supra note 13 (proposing to accelerate NAIC efforts to strengthen the NAIC model laws affecting indexed annuity products and urge adoption by more of the member states).

93 See, e.g., Allianz Letter, supra note 54; American Equity Letter, supra note 54; Letter of R. Preston Pitts (Sept. 10, 2008) ("Pitts Letter"); Sammons Letter, supra note 54; Karlan Tucker, Tucker Advisory Group, Inc. (Sept. 10, 2008) ("Tucker Letter").

the Commission's disclosure scheme is not tailored to these contracts.[94] Commenters cited a number of factors, including the lack of a registration form that is well-suited to indexed annuities, questions about the appropriate method of accounting to be used by insurance companies that issue indexed annuities, questions about advertising restrictions that may apply under the federal securities laws, and concerns about parity of the registration process vis-à-vis mutual funds. We acknowledge that, as a result of indexed annuity issuers having historically offered and sold their contracts without complying with the federal securities laws, the Commission has not created specific disclosure requirements tailored to these products. This fact, though, is not relevant in determining whether indexed annuities are subject to the federal securities laws. The Commission has a long history of creating appropriate disclosure requirements for different types of securities, including securities issued by insurance companies, such as variable annuities and variable life insurance.[95] We note that we are providing a two-year transition period for rule 151A, and, during this period, we intend to consider how to tailor disclosure requirements for indexed annuities. We encourage indexed annuity issuers to work with the Commission during that period to address their concerns.

3. Definition

Scope of the Definition

Rule 151A will apply, as proposed, to a contract that is issued by a corporation

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94 See, e.g., Letter of American Council of Life Insurers (Sep. 19, 2008) ("ACLI Letter"); Allianz Letter, supra note 54; Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; National Western Letter, supra note 54; Sammons Letter, supra note 54; Transamerica Letter, supra note 54.

95 See Form N-4 [17 CFR 239.17b and 274.11c] (registration form for variable annuities); Form N-6 [17 CFR 239.17c and 274.11d] (registration form for variable life insurance).

subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.[96] This language is the same language used in Section 3(a)(8) of the Securities Act. Thus, the insurance companies covered by the rule are the same as those covered by Section 3(a)(8).

In addition, in order to be covered by the rule, a contract must be subject to regulation as an annuity under state insurance law.[97] The rule will not apply to contracts that are regulated under state insurance law as life insurance, health insurance, or any form of insurance other than an annuity, and it does not apply to any contract issued by an insurance company if the contract itself is not subject to regulation under state insurance law.[98] Thus, rule 151A itself will not apply to indexed life insurance policies,[99] in which the cash value of the policy is credited with a guaranteed minimum return and a securities-linked return. The status of an indexed life insurance policy under the federal securities laws will continue to be a facts and circumstances determination, undertaken

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96 Rule 151A(a).

97 Id. We note that the majority of states include in their insurance laws provisions that define annuities. See, e.g., ALA. CODE § 27-5-3 (2008); CAL. INS. CODE § 1003 (West 2007); N.J. ADMIN. CODE tit. 11, § 4-2.2 (2008); N.Y. INS. LAW § 1113 (McKinney 2008). Those states that do not expressly define annuities typically have regulations in place that address annuities. See, e.g., IOWA ADMIN. CODE § 191-15.70 (5078) (2008); KAN. ADMIN. REGS. § 40-2-12 (2008); MINN. STAT. § 61B.20 (2007); MISS. CODE ANN. § 83-1-151 (2008).

98 One commenter was concerned that rule 151A might apply to a certain type of health insurance contract, where some portion of any favorable financial experience of the insurer is refunded to the insured." Letter of America's Health Insurance Plans (Sep. 10, 2008) ("AHIP Letter"). Rule 151A will not apply to contracts that are regulated under state insurance law as health insurance.

99 See, e.g., Aviva Letter, supra note 54; Sammons Letter, supra note 54 (requesting clarification that rule 151A does not apply to indexed life insurance policies).

by reference to the factors and analysis that have been articulated by the Supreme Court and the Commission. We note, however, that the considerations that form the basis for rule 151A are also relevant in analyzing indexed life insurance because indexed life insurance and indexed annuities share certain features (e.g., securities-linked returns).

The adopted rule, like the proposed rule, expressly states that it does not apply to any contract whose value varies according to the investment experience of a separate account.[100] The effect of this provision is to eliminate variable annuities from the scope of the rule.[101] It has long been established that variable annuities are not entitled to the exemption under Section 3(a)(8) of the Securities Act, and, accordingly, the new definition does not cover them or affect their regulation in any way.[102]

Definition of "Annuity Contract" and "Optional Annuity Contract"

We are adopting, with modifications to address commenters' concerns, the proposal that an annuity issued by an insurance company would not be an "annuity contract" or an "optional annuity contract" under Section 3(a)(8) of the Securities Act if the annuity has two characteristics. As adopted, those characteristics are as follows. First, the contract specifies that amounts payable by the insurance company under the contract are calculated at or after the end of one or more specified crediting periods, in

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100 Rule 151A(d).

101 The assets of a variable annuity are held in a separate account of the insurance company that is insulated for the benefit of the variable annuity owners from the liabilities of the insurance company, and amounts paid to the owner under a variable annuity vary according to the investment experience of the separate account. See Black and Skipper, supra note 39, at 174-77 (2000).

102 See, e.g., VALIC, supra note 8, 359 U.S. 65; United Benefit, supra note 8, 387 U.S. 202. In addition, an insurance company separate account issuing variable annuities is an investment company under the Investment Company Act of 1940. See Prudential Ins. Co. of Am. v. SEC, 326 F.2d 383 (3d Cir. 1964).

whole or in part, by reference to the performance during the crediting period or periods of a security, including a group or index of securities.[103] Second, amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract.[104]

Annuities Subject to Rule 151A

The first characteristic, as proposed and as adopted, is intended to describe indexed annuities, which are the subject of the rule. As proposed, this characteristic would simply have required that amounts payable by the insurance company under the contract are calculated, in whole or in part, by reference to the performance of a security, including a group or index of securities.[105] We have modified this characteristic to address the concern expressed by many commenters that, as proposed, the first characteristic was overly broad and would reach annuities that were not indexed annuities.[106] Commenters were concerned that the rule could, for example, be interpreted as extending to traditional fixed annuities, where amounts payable under the contract accumulate at a fixed interest rate, or to discretionary excess interest contracts, where amounts payable under the contract may include a discretionary excess interest

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103 Rule 151A(a)(1).

104 Rule 151A(a)(2).

105 Proposed rule 151A(a)(1).

106 See, e.g., ACLI Letter, supra note 94; Allianz Letter, supra note 54; Aviva Letter, supra note 54; Letter of AXA Equitable Life Insurance Company (Sept. 10, 2008) ("AXA Equitable Letter"); Letter of Financial Services Institute (Sept. 10, 2008) ("FSI Letter"); CAI 151A Letter, supra note 54; Hartford Letter, supra note 55; NAFA Letter, supra note 54; NAIFA Letter, supra note 54; Letter of NAVA (Sept. 10, 2008) ("NAVA Letter"); Old Mutual Letter, supra note 54; Sammons Letter, supra note 54; Second Academy Letter, supra note 54; Transamerica Letter, supra note 54.

component over and above the guaranteed minimum interest rate offered under the contract.[107] With both traditional fixed annuities and discretionary excess interest contracts, the interest rates are often based, at least in part, on the performance of the securities held by the insurer's general account.

The modified language of the first characteristic addresses commenters' concerns in three ways. First, the language requires that the contract itself specify that amounts payable by the insurance company are calculated by reference to the performance of a security. Thus, a contract will not be covered by the proposed rule unless the insurance company is contractually bound to pay amounts that are dependent upon the performance of a security. While an insurance company may, in fact, look to the performance of the securities in its general account in, for example, establishing the rate to be paid under a traditional fixed annuity, such a contract does not itself obligate the insurer to do so or undertake in any way that the purchaser will receive payments that are linked to the performance of any security. Second, the language requires that the amounts payable by the insurance company be calculated at or after the end of one or more specified crediting periods by reference to the performance during the crediting period of a security. That is, in order to be covered by the rule, an annuity contract must provide that the amount to be paid with respect to a crediting period is determined retrospectively, by reference to the performance during the period of a security. This retrospective determination of amounts to be paid is characteristic of indexed annuities and eliminates from the scope of the rule discretionary excess interest contracts, pursuant to which a specified interest rate may be

107 See, e.g., Letter of Association for Advanced Life Underwriting (Oct. 31, 2008); AXA Equitable Letter, supra note 106.

established by reference to the past performance of a security or securities and applied on a prospective basis with respect to a future crediting period. Third, limiting the rule to contracts where the amount payable is determined retrospectively addresses the concerns of the commenters that the rule, as proposed, could reach annuity contracts covered by the rule 151 safe harbor.[108] As explained above, contracts where the amount payable is determined retrospectively do not fall within rule 151.[109]

Rule 151A, like the proposed rule, will apply whenever any amounts payable under the contract under any circumstances, including full or partial surrender, annuitization, or death, satisfy the first characteristic of the rule. If, for example, a contract specifies that the amount payable under a contract upon a full surrender is not calculated at or after the end of one or more specified crediting periods by reference to the performance during the period or periods of a security, but the amount payable upon annuitization is so calculated, then the contract would need to be analyzed under the rule. As another example, if a contract specifies that amounts payable under the contract are partly fixed in amount and partly dependent on the performance of a security in the manner specified by the rule, the contract would need to be analyzed under the rule.

We note that, like the proposal, rule 151A applies to contracts under which amounts payable are calculated by reference to the performance of a security, including a group or index of securities. Thus, the rule, by its terms, applies to indexed annuities but also to other similar annuities where the contract specifies that amounts payable are

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108 AXA Equitable Letter, supra note 106; Hartford Letter, supra note 55; ICI Letter, supra note 7; K&L Gates Letter, supra note 54.

109 See supra note 38 and accompanying text.

retrospectively calculated by reference to a single security or any group of securities.[110] The federal securities laws, and investors' interests in full and fair disclosure and sales practice protections, are equally implicated, whether amounts payable under an annuity are retrospectively calculated by reference to a securities index, another group of securities, or a single security.

The term "security" in rule 151A has the same broad meaning as in Section 2(a)(1) of the Securities Act. Rule 151A does not define the term "security," and our existing rules provide that, unless otherwise specifically provided, the terms used in the rules and regulations under the Securities Act have the same meanings defined in the Act.[111]

"More Likely Than Not" Test

The second characteristic sets forth the test that would define a class of indexed annuity contracts that are not "annuity contracts" or "optional annuity contracts" under the Securities Act and that, therefore, are not entitled to the Section 3(a)(8) exemption. As adopted, the second characteristic defines that class to include those contracts where the amounts payable by the insurance company under the contract are more likely than not to exceed the amounts guaranteed under the contract.

We are adopting the second characteristic as proposed. As explained above, by purchasing such an indexed annuity, the purchaser assumes the risk of an uncertain and

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110 A commenter inquired whether an annuity product whose returns were indexed to the consumer price index, a real estate index, or a commodities index would be considered a security. Letter of Meaghan L. McFadden (Aug. 13, 2008). Rule 151A, by its terms, does not apply to such an annuity.

111 17 CFR 230.100(b).

fluctuating financial instrument, in exchange for exposure to future, securities-linked returns. As a result, the purchaser assumes many of the same risks that investors assume when investing in mutual funds, variable annuities, and other securities. The rule that we are adopting will provide the purchaser of such an annuity with the same protections that are provided under the federal securities laws to other investors who participate in the securities markets, including full and fair disclosure regarding the terms of the investment and the significant risks that he or she is assuming, as well as protections from abusive sales practices and the recommendation of unsuitable transactions. Some commenters raised concerns about the proposed rule's treatment of de minimis amounts of securities-linked returns.[112] These commenters suggested that the smaller the amount of securities-linked return, the less investment risk is assumed by the purchaser, and the more is assumed by the insurer. In particular, commenters suggested that where the securities-linked return is de minimis, the purchaser does not assume the primary investment risk under the contract.[113] However, based on our current understanding, we believe that almost all current indexed annuity contracts provide for securities-linked returns that are more likely than not to exceed a de minimis amount in excess of the guaranteed return. Nevertheless, in the case of an indexed annuity contract that is more likely than not to provide only a de minimis securities-linked return in excess of the guaranteed return, the Commission and the staff would be prepared to consider a request for relief, if appropriate.

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112 See, e.g., CAI 151A Letter, supra note 54; National Western Letter, supra note 54; Sammons, supra note 54.

113 See, e.g., CAI 151A Letter, supra note 54; National Western Letter, supra note 54; Sammons, supra note 54.

Under rule 151A, amounts payable by the insurance company under a contract will be more likely than not to exceed the amounts guaranteed under the contract if this is the expected outcome more than half the time. In order to determine whether this is the case, it will be necessary to analyze expected outcomes under various scenarios involving different facts and circumstances. In performing this analysis, the amounts payable by the insurance company under any particular set of facts and circumstances will be the amounts that the purchaser[114] would be entitled to receive from the insurer under those facts and circumstances. The facts and circumstances include, among other things, the particular features of the annuity contract (e.g., the relevant index, participation rate, and other features), the particular options selected by the purchaser (e.g., surrender or annuitization), and the performance of the relevant securities benchmark (e.g., in the case of an indexed annuity, the performance of the relevant index, such as the Dow Jones Industrial Average, Lehman Brothers Aggregate U.S. Index, Nasdaq 100 Index, or Standard & Poor's 500 Composite Stock Price Index). The amounts guaranteed under a contract under any particular set of facts and circumstances will be the minimum amount that the insurer would be obligated to pay the purchaser under those facts and circumstances without reference to the performance of the security that is used in calculating amounts payable under the contract. Thus, if an indexed annuity, in all circumstances, guarantees that, on surrender, a purchaser will receive 87.5% of an initial purchase payment, plus 1% interest compounded annually, and that any additional payout

[114] For simplicity, we are referring to payments to the purchaser. The rule, however, references payments by the insurer without reference to a specified payee. In performing the analysis, payments to any payee, including the purchaser, annuitant, and beneficiaries, must be included.

will be based exclusively on the performance of a securities index, the amount guaranteed after 3 years will be 90.15% of the purchase payment (87.5% x 1.01 x 1.01 x 1.01).

Determining Whether an Annuity is not an "Annuity Contract" or "Optional Annuity Contract" under Rule 151A

We are adopting, with modifications to address commenters' concerns, the provisions of proposed rule 151A that address the manner in which a determination will be made regarding whether amounts payable by the insurance company under a contract are more likely than not to exceed the amounts guaranteed under the contract. Rule 151A is principles-based, providing that a determination made by the insurer at or prior to issuance of a contract will be conclusive, provided that: (i) both the insurer's methodology and the insurer's economic, actuarial, and other assumptions are reasonable; (ii) the insurer's computations are materially accurate; and (iii) the determination is made not earlier than six months prior to the date on which the form of contract is first offered.[115] We have eliminated the proposed requirement that the insurer's determination be made not more than three years prior to the date on which a particular contract is issued. The rule specifies the treatment of charges that are imposed at the time of payments under the contract by the insurer, and we have modified the proposal in order to provide for consistent treatment of these charges in computing both amounts payable by the insurance company and amounts guaranteed under the contract.[116]

We are adopting this principles-based approach because we believe that an insurance company should be able to evaluate anticipated outcomes under an annuity that

115 Rule 151A(b)(2).

116 Rule 151A(b)(1).

it issues. We believe that many insurers routinely undertake similar analyses for purposes of pricing and valuing their contracts.[117] In addition, we believe that it is important to provide reasonable certainty to insurers with respect to the application of the rule and to preclude an insurer's determination from being second guessed, in litigation or otherwise, in light of actual events that may differ from assumptions that were reasonable when made.

As with all exemptions from the registration and prospectus delivery requirements of the Securities Act, the party claiming the benefit of the exemption – in this case, the insurer – bears the burden of proving that the exemption applies.[118] Thus, an insurer that believes an indexed annuity is entitled to the exemption under Section 3(a)(8) based, in part, on a determination made under the rule will – if challenged in litigation – be required to prove that its methodology and its economic, actuarial, and other assumptions were reasonable, and that the computations were materially accurate.

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117 See generally Black and Skipper, supra note 39, at 26-47, 890-99. Several commenters who issue indexed annuities disputed that insurers undertake these analyses. See, e.g., American Equity Letter, supra note 54; National Western Letter, supra note 54; Sammons Letter, supra note 54. Other commenters, however, confirmed that these analytical methods exist and are used by insurers for internal purposes. See, e.g., Aviva Letter, supra note 54; Academy Letter, supra note 54. We give substantial weight to the views of the American Academy of Actuaries ("Academy") on this point, given their expertise in this type of analysis, and are not persuaded that the contrary comments of several issuers are representative of industry practice. See BLACK'S LAW DICTIONARY 39 (8th ed. 2004) (An actuary is a statistician who determines the present effects of future contingent events and who calculates insurance and pension rates on the basis of empirically based tables.); American Academy of Actuaries, Mission, available at: http://www.actuary.org/mission.asp (The mission of the Academy is to, among other things, provide independent and objective actuarial information, analysis, and education for the formation of sound public policy.).

118 See, e.g., SEC v. Ralston Purina, 346 U.S. 119, 126 (1953) (an issuer claiming an exemption under Section 4 of the Securities Act carries the burden of showing that the exemption applies).

The rule provides that an insurer's determination under the rule will be conclusive only if it is made at or prior to issuance of the contract. Rule 151A is intended to provide certainty to both insurers and investors, and we believe that this certainty will be undermined unless insurance companies undertake the analysis required by the rule no later than the time that an annuity is issued. The rule also provides that, for an insurer's determination to be conclusive, the computations made by the insurance company in support of the determination must be materially accurate. An insurer should not be permitted to rely on a determination of an annuity's status under the rule that is based on computations that are materially inaccurate. For this purpose, we intend that computations will be considered to be materially accurate if any computational errors do not affect the outcome of the insurer's determination as to whether amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

In order for an insurer's determination to be conclusive, both the methodology and the economic, actuarial, and other assumptions used must be reasonable. We recognize that a range of methodologies and assumptions may be reasonable and that a reasonable methodology or assumption utilized by one insurer may differ from a reasonable assumption or methodology selected by another insurer. In determining whether an insurer's methodology is reasonable, it is appropriate to look to methods commonly used for pricing, valuing, and hedging similar products in insurance and derivatives markets.

An insurer will need to make assumptions in several areas, including assumptions about (i) insurer behavior, (ii) purchaser behavior, and (iii) market behavior, and will need to assign probabilities to various potential behaviors. With regard to insurer behavior, the insurer will need to make assumptions about discretionary actions that it may take under the terms of an annuity. In the case of an indexed annuity, for example, an insurer often has discretion to modify various features, such as guaranteed interest rates, caps, participation rates, and spreads. Similarly, the insurer will need to make assumptions concerning purchaser behavior, including matters such as how long purchasers will hold a contract, how they will allocate contract value among different investment options available under the contract, and the form in which they will take payments under the contract. Assumptions about market behavior will include assumptions about expected return, market volatility, and interest rates. In general, insurers will need to make assumptions about any feature of insurer, purchaser, or market behavior, or any other factor, that is material in determining the likelihood that amounts payable under the contract exceed the amounts guaranteed.

In determining whether assumptions are reasonable, insurers should generally be guided by both history and their own expectations about the future. An insurer may look to its own, and to industry, experience with similar or otherwise comparable contracts in constructing assumptions about both insurer behavior and investor behavior. In making assumptions about future market behavior, an insurer may be guided, for example, by historical market characteristics, such as historical returns and volatility, provided that the insurer bases its assumptions on an appropriate period of time and does not have reason to believe that the time period chosen is likely to be unrepresentative. As a general matter, assumptions about insurer, investor, or market behavior that are not consistent with historical experience would not be reasonable unless an insurer has a reasonable basis for any differences between historical experience and the assumptions used.

In addition, an insurer may look to its own expectations about the future in constructing reasonable assumptions. As noted above, insurers routinely analyze anticipated outcomes for purposes of pricing and valuing their contracts. We expect that, in making a determination under rule 151A, an insurer will use assumptions that are consistent with the assumptions that it uses for other purposes, such as pricing and valuation. In addition, an insurer generally should use assumptions that are consistent with its marketing materials. In general, assumptions that are inconsistent with the assumptions that an insurer uses for other purposes will not be reasonable under rule 151A.

As noted above, we are adopting a principles-based approach because we believe that it will provide reasonable certainty to insurers with respect to the application of the rule. We recognize, however, that a number of commenters expressed concern that the principles-based approach provides insufficient guidance regarding implementation and the methodologies and assumptions that are appropriate and could result in inconsistent determinations by different insurance companies and present enforcement and litigation risk.[119] Some commenters suggested that the Commission address these concerns by providing guidance as to how to make the determination under the rule, which, they asserted, could result in greater uniformity and consistency in the application of the

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119 See, e.g., Academy Letter, supra note 54; ACLI Letter, supra note 94; Aviva Letter, supra note 54; AXA Equitable Letter, supra note 106; CAI 151A Letter, supra note 54; FINRA Letter, supra note 7; Letter of Genesis Financial Products, Inc. (Aug. 29, 2008) ("Genesis Letter"); Letter of Janice Hart (Aug. 15, 2008) ("Hart Letter"); ICI Letter, supra note 7; National Western Letter, supra note 54; Sammons Letter, supra note 54.

rule.[120] While we believe that further guidance may, indeed, be helpful in response to specific questions of affected insurance companies, we note that commenters generally did not articulate with specificity the areas where they believe that further guidance is required. As a result, in order to provide guidance in the manner that would be most helpful, we encourage insurance companies, sellers of indexed annuities, and other affected parties to submit specific requests for guidance, which we will consider during the two-year period between adoption of rule 151A and its effectiveness.[121]

Like the proposal, rule 151A requires that, in order for an insurer's determination to be conclusive, the determination must be made not more than six months prior to the date on which the form of contract is first offered.[122] For example, if a form of contract were first offered on January 1, 2012, the insurer would be required to make the determination not earlier than July 1, 2011. We are not adopting the proposed requirement that the insurer's determination be made not more than three years prior to the date on which the particular contract is issued.[123] We were persuaded by the commenters that if the status of a form of contract under the federal securities laws were to change, over time, from exempt to non-exempt and vice versa, this would present practical difficulties resulting from the possibility that an annuity could be exempted from registration at one time but be required to be registered subsequently and vice versa,

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120 See, e.g., FINRA Letter, supra note 7; Hart Letter, supra note 119; ICI Letter, supra note 7; NAIC Officer Letter, supra note 54.

121 See infra text accompanying notes 129 and 130.

122 Rule 151A(b)(2)(iii).

123 Proposed rule 151A(b)(2)(C).

as well as heightened litigation and enforcement risk.[124] We believe that the substantial uncertainties and resulting potential costs introduced by the proposed requirement that a contract's status be redetermined every three years would be inconsistent with the intent of rule 151A, which is to clarify the status of indexed annuities.

Rule 151A, as adopted, requires that, in determining whether amounts payable by the insurance company are more likely than not to exceed the amounts guaranteed, both amounts payable and amounts guaranteed are to be determined by taking into account all charges under the contract, including, without limitation, charges that are imposed at the time that payments are made by the insurance company.[125] For example, surrender charges would be deducted from both amounts payable and amounts guaranteed under the contract. This is a change from the proposal, which would have required that, in determining whether amounts payable by the insurance company under a contract are more likely than not to exceed the amounts guaranteed under the contract, amounts

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124 See, e.g., Aviva Letter, supra note 54; Sammons Letter, supra note 54. See also ICI Letter, supra note 7 (possibility that indexed annuity's status under the federal securities laws could change is not consistent with the purposes of the federal securities laws).

125 Rule 151A(b)(1). In many cases, amounts guaranteed under annuities are not affected by charges imposed at the time payments are made by the insurer under the contract. This is a result of the fact that guaranteed minimum value, as commonly defined in indexed annuity contracts, equals a percentage of purchase payments, accumulated at a specified interest rate, as explained above, and this amount is not subject to surrender charges. However, under some indexed annuity contracts, the amounts guaranteed are affected by charges imposed at the time payments are made. For example, a purchaser buys a contract for $100,000. The contract defines surrender value as the greater of (i) purchase payments plus index-linked interest minus surrender charges or (ii) the guaranteed minimum value. The maximum surrender charge is equal to 10%. The guaranteed minimum value is defined in the contract as 87.5% of premium accumulated at 1% annual interest. If the purchaser surrenders within the first year of purchase, and there is no index-linked interest credited, the surrender value would equal $90,000 (determined under clause (i) as $100,000 purchase payment minus 10% surrender charge), and this amount would be the guaranteed amount under the contract, not the lower amount defined in the contract as guaranteed minimum value ($87,500).

payable be determined without reference to any charges that are imposed at the time of payment, such as surrender charges, while those charges would be reflected in computing the amounts guaranteed under the contract.[126]

We are making the foregoing change because we are persuaded by commenters who argued that the proposed provision could result in contracts being determined not to be entitled to the Section 3(a)(8) exemption irrespective of the likelihood of securities-linked return being included in the amount payable.[127] Specifically, commenters argued that as long as the surrender charge is in effect, the amount payable would always exceed the amount guaranteed if the surrender charge were subtracted from the latter but not the former. The commenters further argued that bona fide surrender charges should not result in a contract being deemed a security, since a surrender charge is an expense and does not represent a transfer of risk from insurer to contract purchaser. Because the rule, as adopted, requires surrender charges to be subtracted from both amounts payable and amounts guaranteed, the surrender charges will not affect the determination of whether a contract is a security (i.e., the determination of whether amounts payable are more likely than not to exceed the amounts guaranteed).

Effective Date

The effective date of rule 151A is January 12, 2011. We originally proposed that rule 151A, if adopted, would be effective 12 months after publication in the Federal Register. We are persuaded by commenters, however, that additional time is required

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126 Proposed rule 151A(b)(1).

127 See, e.g., Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; Coalition Letter, supra note 54.

for, among other things, making the determinations required by the rule, preparing registration statements for indexed annuities that are required to be registered, and establishing the needed infrastructure for distributing registered indexed annuities.[128] Based on the comments, we believe that a January 12, 2011 effective date will provide the time needed to accomplish these tasks.[129] We note that, during this period, the Commission intends to consider how to tailor disclosure requirements for indexed annuities and will also consider any requests for additional guidance that we receive concerning the determinations required under rule 151A.[130]

The new definition in rule 151A will apply prospectively as we proposed – that is, only to indexed annuities issued on or after January 12, 2011. We are using our definitional rulemaking authority under Section 19(a) of the Securities Act, and the explicitly prospective nature of our rule is consistent with similar prospective rulemaking that we have undertaken in the past when doing so was appropriate and fair under the circumstances.[131]

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128 Letter of American International Group (Sept. 10, 2008) ("AIG Letter"); Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; NAVA Letter, supra note 106; Letter of New York Life Insurance Company (Sept. 18, 2008) ("NY Life Letter"); Sammons Letter, supra note 54.

129 AIG Letter, supra note 128 (recommending transition period of 2 years); Aviva Letter, supra note 54 (at least 24 months); CAI 151A Letter, supra note 54 (24 months); Letter of NAVA (Nov. 17, 2008) ("Second NAVA Letter") (at least 24 months); NY Life Letter, supra note 128 (at least 24 months).

130 See supra text accompanying notes 95 and 121.

131 See, e.g., Securities Act Release No. 4896 (Feb. 1, 1968) [33 FR 3142, 3143 (Feb. 17, 1968)] ("The Commission is aware that for many years issuers of the securities identified in this rule have not considered their obligations to be separate securities and that they have acted in reliance on the view, which they believed to be the view of the Commission, that registration under the Securities Act was not required. Under the circumstances, the Commission does not believe that such issuers are subject to any

We are aware that many insurance companies and sellers of indexed annuities, such as insurance agents, broker-dealers, and registered representatives of broker-dealers, in the absence of definitive interpretation or definition by the Commission, have of necessity acted in reliance on their own analysis of the legal status of indexed annuities based on the state of the law prior to this rulemaking. Under these circumstances, we do not believe that issuers and sellers of indexed annuities should be subject to any additional legal risk relating to their past offers and sales of indexed annuity contracts as a result of the proposal and adoption of rule 151A.[132]

Several commenters requested clarification of the statement that rule 151A will apply prospectively to indexed annuities issued on or after the rule's effective date (i.e., January 12, 2011).[133] As a result, we are clarifying that if an indexed annuity has been issued to a particular individual purchaser prior to January 12, 2011, then that specific contract between that individual and the insurance company (including any additional purchase payments made under the contract on or after January 12, 2011) is not subject to

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penalty or other damages resulting from entering into such arrangements in the past. Paragraph (b) provides that the rule shall apply to transactions of the character described in paragraph (a) only with respect to bonds or other evidence of indebtedness issued after adoption of the rule."). See also Securities Act Release No. 5316 (Oct. 6, 1972) [37 FR 23631, 23632 (Nov. 7, 1972)] ("The Commission recognizes that the 'no-sale' concept has been in existence in one form or another for a long period of time. . . . The Commission believes, after a thorough reexamination of the studies and proposals cited above, that the interpretation embodied in Rule 133 is no longer consistent with the statutory objectives of the [Securities] Act. . . . Rule 133 is rescinded prospectively on and after January 1, 1973 . . . .").

132 See FSI Letter, supra note 106 (asking for clarification that, like insurance company issuers, independent broker-dealers and their affiliated financial advisers are not subject to any additional legal risk relating to past offers and sales of indexed annuities as a result of rule 151A).

133 See, e.g., AIG Letter, supra note 128; Hartford Letter, supra note 55; Letter of North American Securities Administrators Association (Sept. 10, 2008) ("NASAA Letter").

rule 151A, and its status under the federal securities laws is to be determined under the law as it existed without reference to rule 151A. By contrast, if an indexed annuity is issued to a particular individual purchaser on or after January 12, 2011, then that specific contract between that individual and the insurance company is subject to rule 151A, even if the same form of indexed annuity was offered and sold prior to January 12, 2011, and even if the individual contract issued on or after January 12, 2011, is issued under a group contract that was in place prior to January 12, 2011.

The Commission believes that permitting new sales of an existing form of contract (as opposed to additional purchase payments made under a specific existing contract between an individual and an insurance company) after the rule's effective date without reference to the rule is contrary to the purpose of the rule. If the rule were not applicable to all contracts issued on or after the effective date without regard to when the forms of the contracts were originally sold, then two substantially similar contracts could be sold after the effective date, one not subject to the rule and one subject to the rule, even though they present the same level of risk to the purchaser and present the same need for investor protection. The fact that one was designed and released into the marketplace prior to January 12, 2011, and the other was designed and released into the marketplace after that date should not be a determining factor as to the availability of the protections of the federal securities laws. We note that, because we have extended the effective date to January 12, 2011, insurers should have adequate time to prepare for compliance with rule 151A.

Some commenters raised concerns that the registration of an indexed annuity as required by rule 151A could cause offers and sales of the same annuity that occurred on an unregistered basis after adoption but prior to the effective date of the rule, January 12, 2011, to be unlawful under Section 5 of the Securities Act.[134]

We reiterate that nothing in this adopting release is intended to affect the current analysis of the legal status of indexed annuities until the effective date of rule 151A. Therefore, after the adoption of rule 151A but prior to the effective date of the rule:

- An indexed annuity issuer making unregistered offers and sales of a contract that will not be an "annuity contract" or "optional annuity contract" under rule 151A may continue to do so until the effective date of rule 151A without such offers and sales being unlawful under Section 5 of the Securities Act as a result of the pending effectiveness of rule 151A; and
- An indexed annuity issuer that wishes to register a contract that will not be an "annuity contract" or "optional annuity contract" under rule 151A may continue to make unregistered offers and sales of the same annuity until the earlier of the effective date of the registration statement or the effective date of the rule without such offers and sales being unlawful under Section 5 of the Securities Act as a result of the pending effectiveness of rule 151A.

Annuities not Covered by the Definition

Rule 151A applies to annuities where the contract specifies that amounts payable by the insurance company under the contract are calculated at or after the end of one or more specified crediting periods, in whole or in part, by reference to the performance during the crediting period or periods of a security, including a group or index of securities. The rule defines certain of those annuities (annuities under which amounts

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134 See, e.g., Aviva Letter, supra note 54; CAI 151A Letter, supra note 54; Sammons Letter, supra note 54.

payable by the issuer are more likely than not to exceed the amounts guaranteed under the contract) as not "annuity contracts" or "optional annuity contracts" under Section 3(a)(8) of the Securities Act. The rule, however, does not provide a safe harbor under Section 3(a)(8) for any other annuities, including any other indexed annuities. The status under the Securities Act of any annuity, other than an annuity that is determined under rule 151A to be not an "annuity contract" or "optional annuity contract," continues to be determined by reference to the investment risk and marketing tests articulated in existing case law under Section 3(a)(8) and, to the extent applicable, the Commission's safe harbor rule 151.[135]

Some commenters suggested that the Commission, instead of adopting a rule that defines certain indexed annuities as not being "annuity contracts" under Section 3(a)(8), should instead define a safe harbor that would provide that indexed annuities that meet certain conditions are entitled to the Section 3(a)(8) exemption.[136] We are not adopting this approach for two reasons. First, such a rule would not address in any way the federal interest in providing investors with disclosure, antifraud, and sales practice protections that arise when individuals are offered indexed annuities that expose them to investment risk. A safe harbor would address circumstances where purchasers of indexed annuities are **not** entitled to the protections of the federal securities laws; one of our primary goals is to address circumstances where purchasers of indexed annuities **are** entitled to the

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135 As noted in Part II.B., above, indexed annuities are not entitled to rely on the rule 151 safe harbor.

136 See, e.g., Academy Letter, supra note 54; AIG Letter, supra note 128; Aviva Letter, supra note 54; Second Academy Letter, supra note 54; Second Aviva Letter, supra note 54; Second Transamerica Letter, supra note 54; Letter of Life Insurance Company of the Southwest (Sept. 10, 2008) ("Southwest Letter"); Voss Letter, supra note 13.

protections of the federal securities laws. We are concerned that many purchasers of indexed annuities today should be receiving the protections of the federal securities laws, but are not. Rule 151A addresses this problem; a safe harbor rule would not. Second, we believe that, under many of the indexed annuities that are sold today, the purchaser bears significant investment risk and is more likely than not to receive a fluctuating, securities-linked return. In light of that fact, we believe that is far more important to address this class of contracts with our definitional rule than to address the remaining contracts, or some subset of those contracts, with a safe harbor rule.

B. Exchange Act Exemption for Securities that are Regulated as Insurance

The Commission is also adopting new rule 12h-7 under the Exchange Act, which provides an insurance company with an exemption from Exchange Act reporting with respect to indexed annuities and certain other securities issued by the company that are registered under the Securities Act and regulated as insurance under state law.[137] Sixteen commenters supported the exemption.[138] No commenters opposed the exemption. We are adopting this exemption, with changes to the proposal that address commenters' concerns, because we believe that the exemption is necessary or appropriate in the public

[137] The Commission received a petition requesting that we propose a rule that would exempt issuers of certain types of insurance contracts from Exchange Act reporting requirements. Letter from Stephen E. Roth, Sutherland Asbill & Brennan LLP, on behalf of Jackson National Life Insurance Co., to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission (Dec. 19, 2007) (File No. 4-553) available at: http://www.sec.gov/rules/petitions/2007/petn4-553.pdf.

[138] See, e.g., ACLI Letter, supra note 94; Allianz Letter, supra note 54; AXA Equitable Letter, supra note 106; Letter of Committee of Annuity Insurers regarding proposed rule 12h-7 (Sept. 10, 2008) ("CAI 12h-7 Letter"); FSI Letter, supra note 106; Letter of Great-West Life & Annuity Insurance Company (Sept. 10, 2008) ("Great-West Letter"); ICI Letter, supra note 7; Letter of MetLife, Inc. (Sept. 11, 2008) ("MetLife Letter"); NAVA Letter, supra note 106; Sammons Letter, supra note 54.

interest and consistent with the protection of investors. We base that view on two factors: first, the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of those activities and assets under state insurance law; and, second, the absence of trading interest in the securities.[139] The new rule imposes conditions to the exemption that relate to these factors and that we believe are necessary or appropriate in the public interest and consistent with the protection of investors.

State insurance regulation is focused on insurance company solvency and the adequacy of insurers' reserves, with the ultimate purpose of ensuring that insurance companies are financially secure enough to meet their contractual obligations.[140] State insurance regulators require insurance companies to maintain certain levels of capital, surplus, and risk-based capital; restrict the investments in insurers' general accounts; limit the amount of risk that may be assumed by insurers; and impose requirements with regard to valuation of insurers' investments.[141] Insurance companies are required to file annual reports on their financial condition with state insurance regulators. In addition, insurance companies are subject to periodic examination of their financial condition by state insurance regulators. State insurance regulators also preside over the conservation

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139 See Section 12(h) of the Exchange Act [15 U.S.C. 78l(h)] (Commission may, by rules, exempt any class of issuers from the reporting provisions of the Exchange Act "if the Commission finds, by reason of the number of public investors, amount of trading interest in the securities, the nature and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors.") (emphasis added).

140 Black and Skipper, supra note 39, at 949.

141 Id. at 949 and 956-59.

or liquidation of companies with inadequate solvency.[142]

State insurance regulation, like Exchange Act reporting, relates to an entity's financial condition. We are of the view that, in appropriate circumstances, it may be unnecessary for both to apply in the same situation, which may result in duplicative regulation that is burdensome. Through Exchange Act reporting, issuers periodically disclose their financial condition, which enables investors and the markets to independently evaluate an issuer's income, assets, and balance sheet. State insurance regulation takes a different approach to the issue of financial condition, instead relying on state insurance regulators to supervise insurers' financial condition, with the goal that insurance companies be financially able to meet their contractual obligations. We believe that it is consistent with our federal system of regulation, which has allocated the responsibility for oversight of insurers' solvency to state insurance regulators, to exempt insurers from Exchange Act reporting with respect to state-regulated insurance contracts. Commenters asserted that, in light of the protections available under state insurance regulation, periodic reporting under the Exchange Act by state-regulated insurers does not enhance investor protection with respect to the securities covered under the rule.[143]

Our conclusion is strengthened by the general absence of trading interest in insurance contracts. Insurance is typically purchased directly from an insurance company. While insurance contracts may be assigned in some circumstances, they typically are not listed or traded on securities exchanges or in other markets. As a result,

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142 Id. at 949.

143 CAI 12h-7 Letter, supra note 138; ICI Letter, supra note 7; MetLife Letter, supra note 138.

outside the context of publicly owned insurance companies, there is little, if any, market interest in the information that is required to be disclosed in Exchange Act reports.

1. The Exemption

Rule 12h-7 provides an insurance company that is covered by the rule with an exemption from the duty under Section 15(d) of the Exchange Act to file reports required by Section 13(a) of the Exchange Act with respect to certain securities registered under the Securities Act.[144]

Covered Insurance Companies

The Exchange Act exemption applies to an issuer that is a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state, including the District of Columbia, Puerto Rico, the Virgin Islands, and any other possession of the United States.[145] In the case of a

144 Introductory paragraph to rule 12h-7. Cf. Rule 12h-3(a) under the Exchange Act [17 CFR 240.12h-3(a)] (suspension of duty under Section 15(d) of the Exchange Act to file reports with respect to classes of securities held by 500 persons or less where total assets of the issuer have not exceeded $10,000,000); Rule 12h-4 under the Exchange Act [17 CFR 240.12h-4] (exemption from duty under Section 15(d) of the Exchange Act to file reports with respect to securities registered on specified Securities Act forms relating to certain Canadian issuers).

Section 15(d) of the Exchange Act requires each issuer that has filed a registration statement that has become effective under the Securities Act to file reports and other information and documents required under Section 13 of the Exchange Act [15 U.S.C. 78m] with respect to issuers registered under Section 12 of the Exchange Act [15 U.S.C. 78l]. Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] requires issuers of securities registered under Section 12 of the Act to file annual reports and other documents and information required by Commission rule.

145 Rule 12h-7(a). The Exchange Act defines "State" as any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Section 3(a)(16) of the Exchange Act [15 U.S.C. 78c(a)(16)]. The term "State" in rule 12h-7 has the same meaning as in the Exchange Act. Rule 12h-7 does not define the term "State," and our existing rules provide that, unless otherwise specifically

variable annuity contract or variable life insurance policy, the exemption applies to the insurance company that issues the contract or policy. However, the exemption does not apply to the insurance company separate account in which the purchaser's payments are invested and which is separately registered as an investment company under the Investment Company Act of 1940 and is not regulated as an insurance company under state law.[146]

Covered Securities

The exemption applies with respect to securities that do not constitute an equity interest in the insurance company issuer and that are either subject to regulation under the insurance laws of the domiciliary state of the insurance company or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction.[147] The exemption does not apply with respect to any other securities issued by an insurance company. As a result, if an insurance company issues securities with respect to which the exemption applies, and other securities that do not entitle the insurer to the exemption, the insurer will remain subject to Exchange Act reporting obligations. For example, if an insurer that is a publicly held stock company[148] also issues insurance contracts that are

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provided, the terms used in the rules and regulations under the Exchange Act have the same meanings defined in the Exchange Act. See rule 240.0-1(b) [17 CFR 240.0-1(b)].

146 The separate account's Exchange Act reporting requirements are deemed to be satisfied by filing annual reports on Form N-SAR. 17 CFR 274.101. See Section 30(d) of the Investment Company Act [15 U.S.C. 80a-30(d)] and rule 30a-1 under the Investment Company Act [17 CFR 270.30a-1].

147 Rule 12h-7(a)(2).

148 A stock life insurance company is a corporation authorized to sell life insurance, which is owned by stockholders and is formed for the purpose of earning a profit for its stockholders. This is in contrast to another prevailing insurance company structure, the mutual life insurance company. In this structure, the corporation authorized to sell life

registered securities under the Securities Act, the insurer generally would be required to file Exchange Act reports as a result of being a publicly held stock company. Similarly, if an insurer raises capital through a debt offering, the exemption does not apply with respect to the debt securities.

The exemption is available with respect to securities that are either subject to regulation under the insurance laws of the domiciliary state of the insurance company or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction.[149] Rule 12h-7 is a broad exemption that applies to any contract that is regulated under the insurance laws of the insurer's home state because we intend that the exemption apply to all contracts, and only those contracts, where state insurance law, and the associated regulation of insurer financial condition, applies. A key basis for the exemption is that investors are already entitled to the financial condition protections of state law and that, under our federal system of regulation, Exchange Act reporting may be unnecessary. Therefore, we believe it is important that the reach of the exemption and the reach of state insurance law be the same. A single commenter addressed the scope of securities with respect to which the proposed exemption would apply, supporting the Commission's approach and noting that limiting the exemption to enumerated types of securities would require the Commission to revisit the rule every few years, or would

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insurance is owned by and operated for the benefit of its policy owners. Black and Skipper, supra note 39, at 577-78.

149 A domiciliary state is the jurisdiction in which an insurer is incorporated or organized. See National Association of Insurance Commissioners Model Laws, Regulations and Guidelines 555-1, § 104 (2007).

provide a significant barrier to the introduction of new investment products.[150]

The Exchange Act exemption applies both to certain existing types of insurance contracts and to types of contracts that are developed in the future and that are registered as securities under the Securities Act. The exemption applies to indexed annuities that are registered under the Securities Act. However, the Exchange Act exemption is independent of rule 151A and applies to types of contracts in addition to those that are covered by rule 151A. There are at least two types of existing insurance contracts with respect to which the Exchange Act exemption applies, contracts with so-called "market value adjustment" ("MVA") features and insurance contracts that provide certain guaranteed benefits in connection with assets held in an investor's account, such as a mutual fund, brokerage, or investment advisory account.

Contracts including MVA features have, for some time, been registered under the Securities Act.[151] Insurance companies issuing contracts with these features have also complied with Exchange Act reporting requirements.[152] MVA features have historically been associated with annuity and life insurance contracts that guarantee a specified rate of return to purchasers.[153] In order to protect the insurer against the risk that a purchaser

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150 Great-West Letter, supra note 138.

151 Securities Act Release No. 6645, supra note 35, 51 FR at 20256-58.

152 See, e.g., ING Life Insurance and Annuity Company (Annual Report on Form 10-K (Mar. 31, 2008)); Protective Life Insurance Company (Annual Report on Form 10-K (Mar. 31, 2008)); Union Security Insurance Company (Annual Report on Form 10-K (Mar. 3, 2008)).

153 Some indexed annuities also include MVA features. See, e.g., Pre-Effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File No. 333-132399) (filed Feb. 7, 2007); Initial Registration Statement on Form S-1 of ING

may make withdrawals from the contract at a time when the market value of the insurer's assets that support the contract has declined due to rising interest rates, insurers sometime impose an MVA upon surrender. Under an MVA feature, the insurer adjusts the proceeds a purchaser receives upon surrender prior to the end of the guarantee period to reflect changes in the market value of its portfolio securities supporting the contract.[154]

More recently, some insurance companies have registered under the Securities Act insurance contracts that provide certain guarantees in connection with assets held in an investor's account, such as a mutual fund, brokerage, or investment advisory account.[155] As a result, the insurers become subject to Exchange Act reporting requirements if they are not already subject to those requirements. These contracts, often called "guaranteed living benefits," are intended to provide insurance to the purchaser against the risk of outliving the assets held in the mutual fund, brokerage, or investment advisory account.[156]

As noted above, the Exchange Act exemption also applies with respect to a guarantee of a security if the guaranteed security is subject to regulation under state

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USA Annuity and Life Insurance Company (File No. 333-133153) (filed Apr. 7, 2006); Pre-Effective Amendment No. 2 to Registration Statement on Form S-3 of Allstate Life Insurance Company (File No. 333-117685) (filed Dec. 20, 2004).

154 See Proposing Release, supra note 3, 73 FR at 37764 (describing MVA features).

155 See, e.g., PHL Variable Life Insurance Company, File No. 333-137802 (Form S-1 filed Feb. 25, 2008); Genworth Life and Annuity Insurance Company, File No. 333-143494 (Form S-1 filed Apr. 4, 2008).

156 See Proposing Release, supra note 3, 73 FR at 37764 (describing guaranteed living benefits).

insurance law.[157] We are adopting this provision because we believe that it is appropriate to exempt from Exchange Act reporting an insurer that provides a guarantee of an insurance contract (that is also a security) when the insurer would not be subject to Exchange Act reporting if it had issued the guaranteed contract. This situation may arise, for example, when an insurance company issues a contract that is a security and its affiliate, also an insurance company, provides a guarantee of benefits provided under the first company's contract.[158]

Finally, the exemption is not available with respect to any security that constitutes an equity interest in the issuing insurance company. As a general matter, an equity interest in an insurer is not covered by the exemption because it is not subject to regulation under state insurance law and often is publicly traded. Nonetheless, we believe that the rule should expressly preclude any security that constitutes an equity interest in the issuing insurance company from being covered by the exemption. Where investors own an equity interest in an issuing insurance company, and are therefore dependent on the financial condition of the issuer for the value of that interest, we believe that they have a significant interest in directly evaluating the issuers' financial condition for themselves on an ongoing basis and that Exchange Act reporting is appropriate.

2. Conditions to Exemption

As described above, we believe that the exemption is necessary or appropriate in

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157 The Securities Act defines "security" in Section 2(a)(1) of the Act [15 U.S.C. 77b(a)(1)]. That definition provides that a guarantee of any of the instruments included in the definition is also a security.

158 For example, an insurance company may offer a registered variable annuity, and a parent or other affiliate of the issuing insurance company may act as guarantor for the issuing company's insurance obligations under the contract.

the public interest and consistent with the protection of investors because of the existence of state regulation of insurers' financial condition and because of the general absence of trading interest in insurance contracts. The Exchange Act exemption that we are adopting, like the proposal, is subject to conditions that are designed to ensure that both of these factors are, in fact, present in cases where an insurance company is permitted to rely on the exemption. We have modified the conditions related to trading interest in one respect to address the concerns of commenters. We have also added a condition to the proposed rule in order to address a commenter's concern.

Regulation of Insurer's Financial Condition

In order to rely on the exemption, an insurer must file an annual statement of its financial condition with, and the insurer must be supervised and its financial condition examined periodically by, the insurance commissioner, bank commissioner, or any agency or any officer performing like functions, of the insurer's domiciliary state.[159] Commenters did not address this condition, and we are adopting this condition as proposed. This condition is intended to ensure that an insurer claiming the exemption is, in fact, subject to state insurance regulation of its financial condition. Absent satisfaction of this condition, Exchange Act reporting would not be duplicative of state insurance regulation, and the exemption would not be available.

Absence of Trading Interest

The Exchange Act exemption is subject to two conditions intended to insure that there is no trading interest in securities with respect to which the exemption applies, and

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159 Rule 12h-7(c). Cf. Section 26(f)(2)(B)(ii) and (iii) of the Investment Company Act [15 U.S.C. 80a-26(f)(2)(B)(ii) and (iii)] (using similar language in requirements that apply to insurance companies that sell variable insurance products).

we are modifying the proposed conditions in one respect to address the concerns of commenters. First, the securities may not be listed, traded, or quoted on an exchange, alternative trading system,[160] inter-dealer quotation system,[161] electronic communications network, or any other similar system, network, or publication for trading or quoting.[162] This condition is designed to ensure that there is no established trading market for the securities. Second, the issuing insurance company must take steps reasonably designed to ensure that a trading market for the securities does not develop.[163] This includes, except to the extent prohibited by the law of any state, including the District of Columbia, Puerto Rico, the Virgin Islands, and any other possession of the United States,[164] or by action of the insurance commissioner, bank commissioner, or any agency or officer performing like functions of any state, requiring written notice to, and acceptance by, the issuer prior to any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis. This condition is designed to ensure that the insurer takes reasonable steps to ensure the absence of trading interest in the securities.

We are adopting the first condition, relating to the absence of listing, trading, and quoting on any exchange or similar system, network, or publication for trading or

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160 For this purpose, "alternative trading system" would have the same meaning as in Regulation ATS. See 17 CFR 242.300(a) (definition of "alternative trading system").

161 For this purpose, "inter-dealer quotation system" would have the same meaning as in Exchange Act rule 15c2-11. See 17 CFR 240.15c2-11(e)(2) (definition of "inter-dealer quotation system").

162 Rule 12h-7(d).

163 Rule 12h-7(e).

164 See supra note 145 for a discussion of the term "State" as used in rule 12h-7.

quoting, as proposed. We are not adopting the suggestion of a commenter that the Commission limit this condition to exchanges and other similar systems, networks, and publications for trading or quoting that are registered with, or regulated by, the Commission or a self-regulatory organization.[165] The commenter argued that, absent this limitation, insurance companies would be placed in the position of enforcing the Commission's requirements by identifying any exchanges and other similar systems, networks, and publications for trading or quoting that may arise from time to time and operate in violation of the Commission's rules and regulations. We disagree that this limitation is appropriate. We have determined that the exemption provided by rule 12h-7 is necessary or appropriate in the public interest and consistent with the protection of investors, in part, because of the absence of trading interest in the insurance contracts covered by the exemption. We do not believe that there would be an absence of trading interest where an insurance contract trades on an exchange or similar system, network, or publication for trading or quoting, whether regulated by the Commission or not.

We are modifying the second condition, which requires the issuing insurance company to take steps reasonably designed to ensure that a trading market for the securities does not develop. As the condition was proposed, this would have included requiring written notice to, and acceptance by, the insurance company prior to any assignment or transfer of the securities and reserving the right to refuse assignments or other transfers of the securities at any time on a non-discriminatory basis.[166] Under the adopted rule, these particular steps will continue to be required, except to the extent that

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165 CAI 12h-7 Letter, supra note 138.

166 Proposed rule12h-7(e).

they are prohibited by the law of any state or by action of the insurance commissioner, bank commissioner, or any agency or officer performing like functions of any state.

This modification addresses the concern expressed by several commenters that the proposed condition could, in some circumstances, be inconsistent with applicable state law.[167] The commenters stated that some states may not permit restrictions on transfers or assignments and, indeed, that some states specifically grant contract owners the right to transfer or assign their contracts. In proposing the condition relating to restrictions on assignment, it was not our intent to require restrictions that are inconsistent with applicable state law. Our modification to rule 12h-7 clarifies this and, accordingly, addresses the commenters' concern.

Three commenters requested that the second condition be removed in its entirety.[168] These commenters stated that the second condition is unnecessary, because the first should give sufficient comfort that a trading market will not arise. The commenters also stated that this condition would be difficult to apply. One of the commenters stated that the condition is ambiguous, and that there is no clear definition of "trading market" in the federal securities laws.[169] We continue to believe that the second condition is important because it will ensure that the issuer takes steps reasonably designed to preclude the development of a trading market. We do not believe that, as modified to address concerns about inconsistency with state law, the second condition

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[167] Allianz Letter, supra note 54; CAI 12h-7 Letter, supra note 138; ICI Letter, supra note 7; NAVA, supra note 106; Sammons Letter, supra note 54.

[168] CAI 12h-7 Letter, supra note 138; Sammons Letter, supra note 54; Transamerica Letter, supra note 54; Second Transamerica Letter, supra note 54.

[169] CAI 12h-7 Letter, supra note 138.

will be unduly difficult to be apply.

Two commenters requested that rule 12h-7 include a transition period for filing required reports under the Exchange Act for any insurance company previously relying on the rule that no longer meets its conditions.[170] We do not believe that it would be appropriate to include such a transition period because, if an insurer no longer meets the conditions, this generally would mean that either the securities are not regulated as insurance under state law or the securities are traded or may become traded. In such a case, the very basis on which we are granting the exemption would no longer exist. Therefore, we have determined not to include such a transition period in rule 12h-7. If an issuer no longer meets the conditions of the rule, it will immediately become subject to the filing requirements of the Exchange Act. We would, in any event, expect situations where an insurance company ceases to meet the conditions of rule 12h-7 to be extremely rare. In such a case, at an insurer's request, we would consider, based on the particular facts and circumstances, whether individual exemptive relief to provide for a transition period would be appropriate.

Prospectus Disclosure

We are adding a condition to proposed rule 12h-7 to require that, in order for an insurer to be entitled to the Exchange Act exemption provided by the rule with respect to securities, the prospectus for the securities must contain a statement indicating that the issuer is relying on the exemption provided by the rule.[171] This addresses a commenter's

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170 Letter of Committee of Annuity Insurers regarding proposed rule 12h-7 (Nov. 17, 2008) ("Second CAI 12h-7 Letter"); Second Transamerica Letter, supra note 54.

171 Rule 12h-7(f).

request that the Commission clarify that reliance on the exemption is optional because some insurers may conclude that the benefits that flow from the ability to incorporate by reference Exchange Act reports may outweigh any costs associated with filing those reports.[172] The new condition will permit an insurance company that desires to remain subject to Exchange Act reporting requirements to do so by omitting the required statement from its prospectus. The new provision also has the advantage of providing notice to investors of an insurer's reliance on the exemption. An insurer who does not include this statement will be subject to mandatory Exchange Act reporting.[173]

3. Effective Date

The effective date of rule 12h-7 is May 1, 2009.

IV. PAPERWORK REDUCTION ACT

A. Background

Rule 151A contains no new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[174] However, we believe that rule 151A will result in an increase in the disclosure burden associated with existing

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172 CAI 12h-7 Letter, supra note 138. See Form S-1, General Instruction VII.A. (incorporation by reference permitted only if, among other things, registrant subject to Exchange Act reporting requirements); Form S-3, General Instruction I.A.2. (Form S-3, which permits incorporation by reference, available to registrant that, among other things, is required to file Exchange Act reports).

173 As described above, the exemption applies to an insurance company that issues a variable annuity contract or variable life insurance policy, but not to the associated separate account. See supra note 146 and accompanying text. On or after the effective date of rule 12h-7, the prospectus for a variable insurance contract with respect to which the insurer does not file Exchange Act reports (and therefore is relying on rule 12h-7) will be required to include the statement that the insurer is relying on rule 12h-7.

174 44 U.S.C. 3501 et seq.

Form S-1 as a result of additional filings that will be made on Form S-1.[175] Form S-1 contains "collection of information" requirements within the meaning of the PRA. Although we are not amending Form S-1, we have submitted the Form S-1 "collection of information" ("Form S-1 Registration Statement" (OMB Control No. 3235-0065)), which we estimate will increase as a result of rule 151A, to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA.[176] We published notice soliciting comment on the increase in the collection of information requirements in the release proposing rule 151A and submitted the proposed collection of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 C.F.R. 1320.11.

We adopted Form S-1 pursuant to the Securities Act. This form sets forth the disclosure requirements for registration statements that are prepared by eligible issuers to provide investors with the information they need to make informed investment decisions in registered offerings. We anticipate that, absent amendments to our disclosure requirements to specifically address indexed annuities, indexed annuities that register under the Securities Act would generally register on Form S-1.[177] As a result, we have

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175 17 CFR 239.11.

176 44 U.S.C. 3507(d); 5 CFR 1320.11.

177 Some Securities Act offerings are registered on Form S-3 [17 CFR 239.13]. We do not believe that rule 151A will have any significant impact on the disclosure burden associated with Form S-3 because we believe that very few, if any, insurance companies that issue indexed annuities will be eligible to register those contracts on Form S-3. In order to be eligible to file on Form S-3, an issuer, must, among other things, have filed Exchange Act reports for a period of at least 12 calendar months. General Instruction I.A.3. of Form S-3. Very few insurance companies that issue indexed annuities are currently eligible to file Form S-3. Further, any insurance companies that issue indexed annuities and rely on the Exchange Act reporting exemption that we are adopting will not meet the eligibility requirements for Form S-3. We believe that very few, if any, issuers

assumed, for purposes of our PRA analysis, that this would be the case. We note, however, that we are providing a two-year transition period for rule 151A and, during this period, we intend to consider how to tailor disclosure requirements for indexed annuities.[178]

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collection of information. 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 information collection requirements related to registration statements on

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of indexed annuities will choose to be subject to the reporting requirements of the Exchange Act because of the costs that this would impose. In any event, the number of indexed annuity issuers that choose to be subject to the reporting requirements of the Exchange Act would be insignificant compared to the total number of Exchange Act reporting companies, which is approximately 12,100. The number of indexed annuity issuers in 2007 was 58. NAVA, supra note 9, at 57.

We also do not believe that the rules will have any significant impact on the disclosure burden associated with reporting under the Exchange Act on Forms 10 K, 10 Q, and 8 K. As a result of rule 12h-7, insurance companies will not be required to file Exchange Act reports on these forms in connection with indexed annuities that are registered under the Securities Act, and, as noted in the prior paragraph, we believe that very few, if any, issuers of indexed annuities will choose to be subject to the reporting requirements of the Exchange Act because of the costs that this would impose. While rule 12h 7 will permit some insurance companies that are currently required to file Exchange Act reports as a result of issuing insurance contracts that are registered under the Securities Act, to cease filing those reports, the number of such companies is insignificant compared to the total number of Exchange Act reporting companies. Likewise, we do not believe that the prospectus statement required under rule 12h-7 for insurers relying on that rule will have any significant impact on the disclosure burden associated with registration statements for insurance contracts that are securities (Forms S-1, S-3, N-3, N-4, and N-6). We do not believe that the currently approved collections of information for these forms will change based on the rule 12h-7 prospectus statement.

178 As noted above, some commenters expressed concern about what they believed to be a lack of a registration form that is well-suited to indexed annuities. See supra text accompanying notes 94 and 95.

Form S-1 are mandatory. There is no mandatory retention period for the information disclosed, and the information disclosed will be made publicly available on the EDGAR filing system.

B. Summary of Information Collection

Because rule 151A will affect the number of filings on Form S-1 but not the disclosure required by this form, we do not believe that the rules will impose any new recordkeeping or information collection requirements. However, we expect that some insurance companies will register indexed annuities in the future that they would not previously have registered. We believe this will result in an increase in the number of annual responses expected with respect to Form S-1 and in the disclosure burden associated with Form S-1. At the same time, we expect that, on a per response basis, rule 151A will decrease the existing disclosure burden for Form S-1. This is because the disclosure burden for each indexed annuity on Form S-1 is likely to be lower than the existing burden per respondent on Form S-1. The decreased burden per response on Form S-1 will partially offset the increased burden resulting from the increase in the annual number of responses on Form S-1. We believe that, in the aggregate, the disclosure burden for Form S-1 will increase as a result of the adoption of rule 151A.

C. Paperwork Reduction Act Burden Estimates

For purposes of the PRA, we estimate that the rule will result in an annual increase in the paperwork burden for companies to comply with the Form S-1 collection of information requirements of approximately 60,000 hours of in-house company personnel time and approximately $72,000,000 for the services of outside professionals. These estimates represent the combined effect of an expected increase in the number of annual responses on Form S-1 and a decrease in the expected burden per response. These estimates include the time and the cost of preparing and reviewing disclosure, filing documents, and retaining records. Our methodologies for deriving the above estimates are discussed below.

We are adopting a new definition of "annuity contract" that, on a prospective basis, defines a class of indexed annuities that are not "annuity contracts" or "optional annuity contracts" for purposes of Section 3(a)(8) of the Securities Act, which provides an exemption under the Securities Act for certain insurance contracts. These indexed annuities will, on a prospective basis, be required to register under the Securities Act on Form S-1.[179]

We received numerous comment letters on the proposal, and we have revised proposed rule 151A in response to the comments. However, we do not believe that any of the modifications affect the estimated reporting and cost burdens discussed in this PRA analysis. These modifications include:

- Revising the proposed definition so that the rule will apply to a contract that specifies that amounts payable by the issuer under the contract are calculated at or after the end of one or more specified crediting periods, in whole or in part, by reference to the performance during the crediting period or periods of a security, including a group or index of securities;[180]

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179 Some Securities Act offerings are registered on Form S-3, but we believe that very few, if any, insurance companies that issue indexed annuities will be eligible to register those contracts on Form S-3. See supra note 177.

180 Rule 151A(a)(1).

- Eliminating the provision in proposed rule 151A that the issuer's determination as to whether amounts payable under the contract are more likely than not to exceed the amounts guaranteed under the contract be made not more than three years prior to the date on which the particular contract is issued;[181] and
- Adopting a requirement that amounts payable by the issuer and amounts guaranteed are to be determined by taking into account all charges under the contract, including, without limitation, charges that are imposed at the time that payments are made by the issuer.[182]

We do not believe that any of these changes will affect the annual increase in the number of responses on Form S-1 or the hours per response required. As we state below, we assume that all indexed annuities that are offered on or after January 12, 2011, will be registered, and that each of the 400 registered indexed annuities will be the subject of one response per year on Form S-1. We do not expect the changes in the rule, as adopted, to affect our estimates of the increase in the number of annual responses required on Form S-1. The first change, revising the scope of the rule, addresses commenters' concerns that the rule was overly broad and would reach annuities that were not indexed annuities, such as traditional fixed annuities and discretionary excess interest contracts. While the revision clarifies the intended scope of the rule to address these concerns, our PRA estimates with respect to the proposed rule were based on the intended scope of the

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181 Proposed Rule 151A(b)(2)(iii).

182 Rule 151A(b)(1).

proposed rule, which did not extend to these other types of annuities. As a result, this change has no effect on our estimates of the number of responses required on Form S-1. Our PRA estimates assume that all indexed annuities that are offered will be registered, and we do not believe that this assumption is affected by the elimination of the requirement that an insurer's determination under rule 151A be made not more than three years prior to the date on which a particular contract is issued or the change to the manner of taking charges into account under the rule. In addition, the changes in the rule will not affect the information required to be disclosed by Form S-1, or the time required to prepare and file the form.

Increase in Number of Annual Responses

For purposes of the PRA, we estimate that there will be an annual increase of 400 responses on Form S-1 as a result of the rule. In 2007, there were 322 indexed annuity contracts offered.[183] For purposes of the PRA analysis, we assume that 400 indexed annuities will be offered each year. This allows for some escalation in the number of contracts offered in the future over the number offered in 2007. Our Office of Economic Analysis has considered the effect of the rule on indexed annuity contracts with typical terms and has determined that these contracts would not meet the definition of "annuity contract" or "optional annuity contract" if they were to be issued after the effective date of the rule. Therefore, we assume that all indexed annuities that are offered will be registered, and that each of the 400 registered indexed annuities will be the subject of one

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183 See NAVA, supra note 9, at 57.

response per year on Form S-1,[184] resulting in the estimated annual increase of 400 responses on Form S-1.

Decrease in Expected Hours Per Response

For purposes of the PRA, we estimate that there will be a decrease of 120 hours per response on Form S-1 as a result of the rule. Current OMB approved estimates and recent Commission rulemaking estimate the hours per response on Form S-1 as 950.[185] The current hour estimate represents the burden for all issuers, both large and small. We believe that registration statements on Form S-1 for indexed annuities will result in a significantly lower number of hours per response, which, based on our experience with other similar contracts, we estimate as 600 hours per indexed annuity response on Form S-1. We attribute this lower estimate to two factors. First, the estimated 400 indexed annuity registration statements will likely be filed by far fewer than 400 different insurance companies,[186] and a significant part of the information in each of the multiple registration statements filed by a single insurance company will be the same, resulting in economies of scale with respect to the multiple filings. Second, many of the 400

184 Annuity contracts are typically offered to purchasers on a continuous basis, and as a result, an insurer offering an annuity contract that is registered under the Securities Act generally will be required to update the registration statement once a year. See Section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)] (when prospectus used more than 9 months after effective date of registration statement, information therein generally required to be not more than 16 months old).

185 These estimates have been revised by other rules that the Commission has adopted, and OMB approval is pending. See Supporting Statement to the Office of Management and Budget under the PRA for Securities Act Release No. 8876, available at: http://www.reginfo.gov/public/do/DownloadDocument?documentID=90204&version=0 ("33-8876 Supporting Statement").

186 The 322 indexed annuities offered in 2007 were issued by 58 insurance companies. See NAVA, supra note 9, at 57.

responses on Form S-1 each year will be annual updates to registration statements for existing contracts, rather than new registration statements, resulting in a significantly lower hour burden than a new registration statement.[187] Combining our estimate of 600 hours per indexed annuity response on Form S-1 (for an estimated 400 responses) with the existing estimate of 950 hours per response on Form S-1 (for an estimated 768 responses),[188] our new estimate is 830 hours per response (((400 x 600) + (768 x 950))/1168).

Net Increase in Burden

To calculate the total effect of the rules on the overall compliance burden for all issuers, large and small, we added the burden associated with the 400 additional Forms S-1 that we estimate will be filed annually in the future and subtracted the burden associated with our reduced estimate of 830 hours for each of the current estimated 768 responses. We used current OMB approved estimates in our calculation of the hours and cost burden associated with preparing, reviewing, and filing Form S-1.

Consistent with current OMB approved estimates and recent Commission rulemaking,[189] we estimate that 25% of the burden of preparation of Form S-1 is carried by the company internally and that 75% of the burden is carried by outside professionals retained by the issuer at an average cost of $400 per hour.[190] The portion of the burden

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187 See supra note 184.

188 See 33-8876 Supporting Statement, supra note 185.

189 See Securities Act Release No. 8878 (Dec. 19, 2007) [72 FR 73534, 73547 (Dec. 27, 2007)].

190 Id. at note 110 and accompanying text.

carried by outside professionals is reflected as a cost, while the burden carried by the company internally is reflected in hours.

The tables below illustrate our estimates concerning the incremental annual compliance burden in the collection of information in hours and cost for Form S-1.

Incremental PRA Burden Due to Increased Filings

Estimated Increase in Annual Responses	Hours/Response	Incremental Burden (hours)
400	830	332,000

Incremental Decrease in PRA Burden Due to Decrease in Hours Per Response

Estimated Decrease in Hours/Response	Current Estimated Number of Annual Filings	Incremental Decrease in Burden (hours)
(120)	768	(92,200)

Summary of Change in Incremental Compliance Burden

Incremental Burden (hours)	25% Issuer (hours)	75% Professional (hours)	$400/hr. Professional Cost
240,000	60,000	180,000	$72,000,000

D. Response to Comments on Commission's Paperwork Reduction Act Analysis

A few commenters commented on the Commission's Paperwork Reduction Act analysis in the Proposing Release.[191] One commenter stated that external costs of registering indexed annuities on Form S-1 will vary considerably depending on whether the insurer has previously prepared a Form S-1.[192] The commenter stated that, for

191 See, e.g., Allianz Letter, supra note 54; Second Aviva Letter, supra note 54; Letter of National Association for Fixed Annuities (Nov. 17, 2008) ("Second NAFA Letter"); Transamerica Letter, supra note 54.

192 Allianz Letter, supra note 54.

insurers that have not previously prepared a Form S-1 registration statement, external legal costs could be as high as $250,000-$500,000 for each registration statement. The same commenter estimated external legal costs for an issuer that has previously filed a Form S-1 at $50,000-$100,000. Another commenter estimated external legal costs for preparation and filing of a Form S-1 registration statement with the SEC at $350,000 for the first few years, which, the commenter stated, would decrease over time as the insurer gained more expertise.[193] However, these commenters did not specify the sources of these cost estimates or how they were made.

As stated above, we estimate the average burden per indexed annuity response on Form S-1 to be 600 hours. We further estimate that 75% of that burden will be carried by outside professionals retained by the issuer at an average cost of $400 per hour. Accordingly, we estimate the cost for outside professionals for each indexed annuity registration statement on Form S-1 to be on average $180,000 ((600 X .75) x $400). We do not believe that it is necessary to change our estimate of outside professional costs based on the commenters' estimated costs. The $250,000-$500,000 range cited by the commenters is for an issuer that has not previously filed a Form S-1, with commenters acknowledging that the costs to an experienced filer would be lower (as low as $50,000-$100,000). Our $180,000 estimate reflects outside professional costs incurred not only by first-time Form S-1 filers, but also the costs of preparing Form S-1 for contracts offered by experienced Form S-1 filers, as well as annual updates to existing Form S-1

193 Second Aviva Letter, supra note 54.

registration statements, which we expect to be significantly lower than costs incurred by first-time filers.

One commenter cites a cost of $255,000 for the insurer to prepare a registration statement.[194] It is not clear whether this cost represents only external costs or total costs. The commenter also estimates the cost of preparing a registration statement for certain types of carriers at $62,500[195] and further indicates that there are 27 such carriers issuing indexed annuities, which is approximately half the number of insurers currently issuing indexed annuities.[196] Because the commenter does not provide information as to the basis for the $255,000 figure, and because the $62,500 figure is substantially below the Commission's estimate of $180,000, we are not revising our estimate of the burden of registering an indexed annuity on Form S-1 to reflect these estimates.

Another commenter stated that the Commission's estimate of outside professional costs of $400 per hour does not reflect market rates for securities counsel.[197] However, the commenter did not cite a different rate and did not explain the basis for its disagreement with the $400 per hour rate cited by the Commission. Our estimate of $400 per hour for outside professionals retained by the issuer is consistent with recent rulemakings and is based on discussions between our staff and several law firms.[198]

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[194] Second NAFA Letter, supra note 191.

[195] This estimate is for carriers "without variable authority." The commenter does not explain the meaning of the phrase "without variable authority."

[196] NAVA, supra note 9, at 57 (58 companies issued indexed annuities in 2007).

[197] Transamerica Letter, supra note 54.

[198] See, e.g., Securities Act Release No. 8909 (Apr. 10, 2008) [73 FR 20512, 20515 (Apr. 15, 2008)] ("Revisions to Form S-11 Release").

Accordingly, we are not changing our estimate of the cost per hour of outside professional costs. The commenter further stated that the estimates of time involved are low for persons unfamiliar with the process of registration of securities under the federal securities laws and the anticipated need for interaction with Commission staff. However, as discussed, our estimate of time required to prepare a registration statement reflects time needed not only by first-time Form S-1 filers, but also the time involved in preparing Form S-1 for contracts offered by experienced Form S-1 filers, as well as annual updates to the existing Form S-1 registration statement, which we expect to be significantly less than time needed by first-time filers. We are not revising our estimate of time involved in preparing registration statements on Form S-1.

V. COST-BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. Rule 151A 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. Section 3(a)(8) of the Securities Act provides an exemption for certain insurance contracts. The rule prospectively defines certain indexed annuities as not being "annuity contracts" or "optional annuity contracts" under this insurance exemption if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract. With respect to these annuities, investors are entitled to all the protections of the federal securities laws, including full and fair disclosure and sales practice protections. We are also adopting new rule 12h-7 under the Exchange Act, which exempts certain insurance companies from Exchange Act reporting with respect to indexed annuities and certain other securities that are registered under the Securities Act and regulated as insurance under state law.

In the Proposing Release, we identified certain costs and benefits and requested comment on our cost-benefit analysis, including identification of any costs and benefits not discussed. We also requested that commenters provide empirical data and factual support for their views.

Discussed below is our analysis of the costs and benefits of rules 151A and 12h-7, as well as the issues raised by commenters. As noted above, we are sensitive to the costs imposed by our rules and we have estimated the costs associated with adoption of rule 151A. We emphasize, however, that the burdens of complying with the federal securities laws apply to all market participants who issue or sell securities under the federal securities laws. Rule 151A, by defining those indexed annuities that are not entitled to the Section 3(a)(8) exemption, does not impose any greater or different burdens than those imposed on other similarly situated market participants. Rather, the effect of rule 151A is that issuers and sellers of indexed annuities that are not entitled to the Section 3(a)(8) exemption are treated in the same manner under the federal securities laws as issuers and sellers of other registered securities, and that investors purchasing these instruments receive the same disclosure, antifraud, and sales practice protections that apply when they are offered and sold other securities that pose similar investment risks.

A. Benefits

We anticipate that the rules will benefit investors and covered institutions by: (i) creating greater regulatory certainty with regard to the status of indexed annuities under the federal securities laws; (ii) enhancing disclosure of information needed to make informed investment decisions about indexed annuities; (iii) applying sales practice protections to those indexed annuities that are outside the insurance exemption; (iv) enhancing competition; and (v) relieving from Exchange Act reporting obligations insurers that issue certain securities that are regulated as insurance under state law.

Regulatory Certainty

Rule 151A will provide the benefit of increased regulatory certainty to insurance companies that issue indexed annuities and the distributors who sell them, as well as to purchasers of indexed annuities. The status of indexed annuities under the federal securities laws has been uncertain since their introduction in the mid-1990s. Under existing precedents, the status of each indexed annuity is determined based on a facts and circumstances analysis of factors that have been articulated by the U.S. Supreme Court. Rule 151A will bring greater certainty into this area by defining a class of indexed annuities that are outside the scope of the insurance exemption and by providing that an insurer's determination, in accordance with the rule, will be conclusive.

Indexed annuities possess both insurance and securities features, and fall somewhere between traditional fixed annuities, which are clearly insurance falling within Section 3(a)(8), and variable annuities, which are clearly securities. We have carefully considered where to draw the line, and we believe that the line that we have drawn is rational and reasonably related to fundamental concepts of risk and insurance.

Some commenters agreed that the proposal would provide greater regulatory certainty.[199] One commenter stated that current uncertainty regarding the status of

[199] See, e.g., Advantage Group Letter, supra note 54; Cornell Letter, supra note 7; FINRA Letter, supra note 7; ICI Letter, supra note 7; Letter of State of Washington Department of Financial Institutions Securities Division (Nov. 17, 2008) ("Washington State Letter").

indexed annuities has impeded the ability of regulators to protect indexed annuity consumers,[200] and another stated that it is apparent that clarification is needed and will set a clear national standard of regulatory oversight for indexed annuities.[201] Some commenters, however, expressed concern that the principles-based approach provides insufficient guidance regarding implementation and the methodologies and assumptions that are appropriate and could result in inconsistent determinations by different insurance companies and present enforcement and litigation risk.[202] While we believe that further guidance may be helpful in response to specific questions from affected insurance companies, commenters generally did not articulate with specificity the areas where they believe that further guidance is required. As a result, in order to provide guidance in the manner that would be most helpful, we encourage insurance companies, sellers of indexed annuities, and other affected parties to submit specific requests for guidance, which we will consider during the two-year period between adoption of rule 151A and its effectiveness.

Disclosure

Rule 151A extends the benefits of full and fair disclosure under the federal securities laws to investors in indexed annuities that, under the rule, fall outside the insurance exemption. Without such disclosure, investors face significant obstacles in making informed investment decisions with regard to purchasing indexed annuities that expose them to investment risk. Indexed annuities are similar in many ways to mutual

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200 FINRA Letter, supra note 7;

201 Washington State Letter, supra note 199.

202 See supra note 119.

funds, variable annuities, and other securities. Investors in indexed annuities are confronted with many of the same risks and benefits that other securities investors are confronted with when making investment decisions. Extending the federal securities disclosure regime to indexed annuities under which amounts payable by the insurer are more likely than not to exceed the amounts guaranteed should help to provide investors with the information they need.

Disclosures required for registered indexed annuities include information about costs (such as surrender charges); the method of computing indexed return (e.g., applicable index, method for determining change in index, caps, participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits). We think there are significant benefits to the disclosures provided under the federal securities laws. This information will be public and accessible to all investors, intermediaries, third party information providers, and others through the Commission's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system. Public availability of this information will be helpful to investors in making informed decisions about purchasing indexed annuities. The information will enhance investors' ability to compare various indexed annuities and also to compare indexed annuities with mutual funds, variable annuities, and other securities and financial products. The potential liability for materially false and misleading statements and omissions under the federal securities laws will provide additional encouragement for accurate and complete disclosures by insurers that issue indexed annuities and by the broker-dealers who sell indexed annuities that are not "annuity contracts" under rule 151A to the "thorough, standardized, accessible, and transparent disclosure requirements and antifraud rules of the federal securities laws." [206]

However, some commenters argued that the proposed rule would not result in enhanced disclosure, in particular because the Commission's disclosure scheme is not tailored to indexed annuities and Form S-1 is not well-suited to indexed annuities.[207] We acknowledge that, as a result of indexed annuity issuers having historically offered and sold their contracts without complying with the federal securities laws, the Commission has not created specific disclosure requirements tailored to these products. This fact, though, is not relevant in determining whether indexed annuities are subject to the federal securities laws. The Commission has a long history of creating appropriate disclosure requirements for different types of securities, including securities issued by insurance companies, such as variable annuities and variable life insurance.[208] We note that we are providing a two-year transition period for rule 151A, and, during this period, we intend to consider how to tailor disclosure requirements for indexed annuities. We encourage indexed annuity issuers to work with the Commission during that period to address their concerns.

Some commenters also cited recent efforts by state insurance regulators to address disclosure concerns with respect to indexed annuities as evidence that federal securities

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206 Hartford Letter, supra note 55.

207 See supra note 94 and accompanying text.

208 See Form N-4 [17 CFR 239.17b and 274.11c] (registration form for variable annuities); Form N-6 [17 CFR 239.17c and 274.11d] (registration form for variable life insurance).

regulation is unnecessary.[209] However, as we state above, we disagree. We do not believe that the states' regulatory efforts, no matter how strong, can substitute for our obligation to identify securities covered by the federal securities laws and the protections Congress intended to apply. State insurance laws, enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws.

We have carefully considered the concerns raised by commenters, and we continue to believe that rule 151A will greatly enhance disclosures regarding indexed annuities. In addition to the specific benefits described above, we anticipate that these enhanced disclosures will also benefit the overall financial markets and their participants.

We anticipate that the disclosure of terms of indexed annuities will be broadly beneficial to investors, enhancing the efficiency of the market for indexed annuities through increased competition. Disclosure will make information on indexed annuity contracts, including terms, publicly available. Public availability of terms will better enable investors to compare indexed annuities and may focus attention on the price competitiveness of these products. It will also improve the ability of third parties to price contracts, giving purchasers a better understanding of the fees implicit in the products. We anticipate that third-party information providers may provide services to price or compare terms of different indexed annuities. Analogously, we note that public disclosure of mutual fund information has enabled third-party information aggregators to

209 See supra note 81 and accompanying text.

facilitate comparison of fees.[210] We believe that increasing the level of price transparency and the resulting competition through enhanced disclosure regarding indexed annuities would be beneficial to investors. It could also expand the size of the market, as investors may have increased confidence that indexed annuities are competitively priced.

Sales Practice Protections

Investors will also benefit because, under the federal securities laws, persons effecting transactions in indexed annuities that fall outside the insurance exemption under rule 151A will be required to be registered broker-dealers or become associated persons of a broker-dealer through a networking arrangement. Thus, the broker-dealer sales practice protections will apply to transactions in registered indexed annuities. As a result, investors who purchase these indexed annuities after the effective date of rule 151A will receive the benefits associated with a registered representative's obligation to make only recommendations that are suitable. The registered representatives who sell registered indexed annuities will be subject to supervision by the broker-dealer with which they are associated. Both the selling broker-dealer and its registered representatives will be subject to the oversight of FINRA.[211] The registered broker-dealers will also be required

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210 See, e.g., FINRA, Fund Analyzer, available at: http://www.finra.org/fundanalyzer ("FINRA Fund Analyzer").

211 Cf. NASD Rule 2821 (rule designed to enhance broker-dealers' compliance and supervisory systems and provide more comprehensive and targeted protection to investors regarding deferred variable annuities). See Order Approving FINRA's NASD Rule 2821 Regarding Members' Responsibilities for Deferred Variable Annuities (Approval Order), Securities Exchange Act Release No. 56375 (Sept. 7, 2007), 72 FR 52403 (Sept. 13, 2007) (SR-NASD-2004-183); Corrective Order, Securities Exchange Act Release No. 56375A (Sept. 14, 2007), 72 FR 53612 (September 19, 2007) (SR-NASD-2004-183) (correcting the rule's effective date).

to comply with specific books and records, supervisory, and other compliance requirements under the federal securities laws, as well as be subject to the Commission's general inspections and, where warranted, enforcement powers.

A number of commenters agreed that indexed annuity purchasers will benefit from the sales practice protections accorded by the federal securities laws.[212] These commenters indicated that sales practice protections accorded by the federal securities laws are the most effective means of preventing abusive sales practices. Some commenters specifically stated that the protections of the federal securities laws are needed for the protection of seniors in the indexed annuity marketplace.[213]

As stated above, however, a number of commenters argued that, because of efforts by state insurance regulators to address sales practice concerns with respect to indexed annuities, federal securities regulation is unnecessary and could result in duplicative or overlapping regulation.[214] Commenters cited, in particular, the adoption by the majority of states of the NAIC Suitability in Annuity Transactions Model Regulation.[215] Commenters also cited the existence of state market conduct examinations, the use of state enforcement and investigative authority, licensing and

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212 See, e.g., Alabama Letter, supra note 72; Cornell Letter, supra note 7; FPA Letter, supra note 72; FINRA Letter, supra note 7; Hartford Letter, supra note 55; Wyoming Letter, supra note 72.

213 Alabama Letter, supra note 72; Wyoming Letter, supra note 72.

214 See supra note 81 and accompanying text.

215 NAIC SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION (Model 275-1) (2003). National Association of Insurance Commissioners, Draft Model Summaries, available at: http://www.naic.org/committees_models.htm. See, e.g., Letter A, supra note 76; American Bankers Letter, supra note 74; CAI 151A Letter, supra note 54; NAFA Letter, supra note 54; NAIC Officer Letter, supra note 54; NAIFA Letter, supra note 54.

education requirements applicable to insurance agents who sell indexed annuities, and a number of recent and ongoing efforts by state insurance regulators.[216] Commenters also noted recent efforts by state regulators addressed to annuities generally, such as the creation of NAIC working groups to review and consider possible improvements to the NAIC Suitability in Annuity Transactions Model Regulation.[217]

However, for the same reasons that we do not believe recent state disclosure efforts can substitute for federally required disclosures, we do not believe that the state's efforts to address sales practice concerns, no matter how strong, can substitute for our responsibility to identify securities covered by the statutes and the protections Congress intended to apply. State insurance laws, enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws.[218] Where the purchaser of an indexed annuity assumes the investment risk of an instrument that fluctuates with the securities markets, and the contract therefore does not fall within the Section 3(a)(8) exemption, the application of state insurance regulation, no matter how effective, is not determinative as to whether the contract is subject to the federal securities laws.

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216 See, e.g., American Equity Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54; Iowa Letter, supra note 74; Maryland Letter, supra note 54; NAIC Officer Letter, supra note 54; NAFA Letter, supra note 54.

217 See, e.g., NAIC Officer Letter, supra note 54.

218 Indeed, at least one state regulator acknowledged the developmental nature of state efforts and the lack of uniformity in those efforts. See Voss Letter, supra note 13.

Enhanced Competition

Rule 151A may result in enhanced competition among indexed annuities, as well as between indexed annuities and other competing financial products, such as mutual funds and variable annuities. Rule 151A will result in enhanced disclosure, and, as a result, more informed investment decisions by potential investors, which may enhance competition among indexed annuities and competing products. The greater clarity that results from rule 151A may enhance competition as well because insurers who may have been reluctant to issue indexed annuities while their status was uncertain may now decide to enter the market. Similarly, registered broker-dealers who currently may be unwilling to sell unregistered indexed annuities because of their uncertain regulatory status may become willing to sell indexed annuities that are registered, thereby increasing competition among distributors of indexed annuities. Further, we believe that the Exchange Act exemption may enhance competition among insurance products and between insurance products and other financial products because the exemption may encourage insurers to innovate and introduce a range of new insurance contracts that are securities, since the exemption will reduce the regulatory costs associated with doing so. Increased competition may benefit investors through improvements in the terms of insurance products and other financial products, such as reductions of direct or indirect fees.

We anticipate that the disclosure of terms of indexed annuities will be broadly beneficial to investors, enhancing the efficiency of the market for indexed annuities through increased competition. Disclosure will make information on indexed annuity contracts, including terms, publicly available. Public availability of terms will better enable investors to compare indexed annuities and may focus attention on the price competitiveness of these products. It will also improve the ability of third parties to price contracts, giving purchasers a better understanding of the fees implicit in the products. We anticipate that third-party information providers may provide services to price or compare terms of different indexed annuities. Analogously, we note that public disclosure of mutual fund information has enabled third-party information aggregators to facilitate comparison of fees.[219] We believe that increasing the level of price transparency and the resulting competition through enhanced disclosure regarding indexed annuities would be beneficial to investors. It could also expand the size of the market, as investors may have increased confidence that indexed annuities are competitively priced.

A number of commenters argued that proposed rule 151A would hinder competition, citing a number of factors that they argued would result in indexed annuities becoming less available.[220] Commenters indicated that they did not believe that broker-dealers would become more willing to sell indexed annuities.[221] They stated that broker-

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219 See, e.g., FINRA Fund Analyzer, supra note 210.

220 See, e.g., Advantage Group Letter, supra note 54; Allianz Letter, supra note 54; American Equity Letter, supra note 54; American National Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54; FBL Letter, supra note 73; National Western Letter, supra note 54; Old Mutual Letter, supra note 54; Southwest Letter, supra note 136.

We note that a number of commenters supporting the proposal are industry participants, such as insurers, see, e.g., Hartford letter, supra note 55, and industry groups, see, e.g., ICI letter, supra note 7.

221 See, e.g., Allianz Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54.

dealers have limited "shelf space" for new products.[222] One commenter stated that a broker-dealer would incur start-up costs in selling indexed annuities, such as becoming familiar with the products, performing due diligence, setting up supervisory systems, introducing appropriate technology, and becoming licensed to sell insurance, and these costs would deter a broker-dealer from selling indexed annuities.[223] A number of commenters stated that many agents currently selling indexed annuities would stop selling them, rather than incur the costs of becoming licensed to sell securities and becoming associated with a broker-dealer.[224] Two commenters stated that some agents would not be able to associate with a broker-dealer due to remote locations of the agents, so that rural areas would be underserved.[225] Commenters further pointed to obstacles to distributors networking with registered broker-dealers.[226] Commenters also stated that some insurance companies may stop issuing indexed annuities, because of the rule's adverse impact on distribution and because of the costs that the rule would impose on insurers, such as the cost of registering indexed annuities.[227]

The Commission believes that there could be costs associated with diminished competition as a result of rule 151A. As the commenters note, some insurance

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222 See, e.g., Allianz Letter, supra note 54; Aviva Letter, supra note 54.

223 Allianz Letter, supra note 54.

224 See, e.g., Allianz Letter, supra note 54; American Equity Letter, supra note 54; Aviva Letter, supra note 54; Coalition Letter, supra note 54.

225 Second Old Mutual Letter, supra note 76; Southwest Letter, supra note 136.

226 See, e.g., American Equity Letter, supra note 54; Coalition Letter, supra note 54; Old Mutual Letter, supra note 54.

227 See, e. g., Aviva Letter, supra note 54; National Western Letter, supra note 54; Old Mutual Letter, supra note 54.

companies may stop issuing indexed annuities, and some broker-dealers and agents may determine not to sell indexed annuities. We recognize that the impact of rule 151A on competition may be mixed, but, on balance, we continue to believe that rule 151A will provide the benefits described above and has the potential to increase competition. In this regard, the demand for financial products is relatively fixed, in the aggregate. Any potential reduction in indexed annuities sold under the rule would likely correspond with an increase in the sale of other financial products, such as mutual funds or variable annuities. Thus, total reductions in competition may not be significant, when effects on the financial industry as a whole, including insurance companies together with other providers of financial instruments, are considered. Within the insurance industry, if some insurers cease selling indexed annuities, it is also likely that these insurers will sell other products through the same distribution channels, such as annuities with fixed interest rates.

Relief from Reporting Obligations

The exemption from Exchange Act reporting requirements with respect to certain securities that are regulated as insurance under state law will provide a cost savings to insurers. We have identified approximately 24 insurance companies that currently are subject to Exchange Act reporting obligations solely as a result of issuing insurance contracts that are securities and that we believe will be entitled to an exemption from Exchange Act reporting obligations under rule 12h-7.[228] We estimate that, each year,

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228 In addition, because we are adopting both rules 151A and 12h-7, insurers that currently are not Exchange Act reporting companies and that will be required to register indexed annuities under the Securities Act will be entitled to rely on the Exchange Act exemption and obtain the benefits of the exemption. We have not included potential cost savings to

these insurers file an estimated 24 annual reports on Form 10-K, 72 quarterly reports on Form 10-Q, and 26 reports on Form 8-K.[229] Based on current cost estimates, we believe that the total estimated annual cost savings to these companies will be approximately $15,414,600.[230]

One commenter estimated a higher cost savings.[231] The commenter estimated costs of $1.5 - $2 million annually for an issuer to comply with Exchange Act reporting obligations. Under our current cost estimates, we estimate that it costs $642,275 per

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these companies in our computation because they are not currently Exchange Act reporting companies.

229 These estimates are based on the requirement to file one Form 10-K each year and three Forms 10-Q each year, and on our review of the actual number of Form 8-K filings by these insurers in calendar year 2007.

230 This consists of $8,748,950 attributable to internal personnel costs, representing 49,994 burden hours at $175 per hour, and $6,665,600 attributable to the costs of outside professionals, representing 16,664 burden hours at $400 per hour. Our estimates of $175 per hour for internal time and $400 per hours for outside professionals are consistent with the estimates that we have used in recent rulemaking releases.

Our total burden hour estimate for Forms 10-K, 10-Q, and 8-K is 66,658 hours, which, consistent with current OMB estimates and recent Commission rulemaking, we have allocated 75% (49,994 hours) to the insurers internally and 25% (16,664 hours) to outside professional time. See Supporting Statement to the Office of Management and Budget under the PRA for Securities Act Release No. 8819, available at: http://www.reginfo.gov/public/do/DownloadDocument?documentID=42924&version=1. The total burden hour estimate was derived as follows. The burden attributable to Form 10-K is 52,704 hours, representing 24 Forms 10-K at 2,196 hours per Form 10-K. The burden attributable to Form 10-Q is 13,824 hours, representing 72 Forms 10-Q at 192 hours per Form 10-Q. The burden attributable to Form 8-K is 130 hours, representing 26 Forms 8-K at 5 hours per Form 8-K. The burden hours per response for Form 10-K (2,196 hours), Form 10-Q (192 hours), and Form 8-K (5 hours) are consistent with current OMB estimates.

231 Great-West Letter, supra note 138.

issuer[232] to comply with these obligations. We are not revising our estimate, however, because the commenter did not explain how it arrived at its estimate and we have no basis for determining whether or not it is accurate.

B. Costs

While the rules we are adopting will result in significant cost savings for insurers as a result of the exemption from Exchange Act reporting requirements, we believe that there will be costs associated with the rules. These include costs associated with: (i) determining under rule 151A whether amounts payable by the insurer under an indexed annuity are more likely than not to exceed the amounts guaranteed under the contract; (ii) preparing and filing required Securities Act registration statements with the Commission; (iii) printing prospectuses and providing them to investors; (iv) entering into a networking arrangement with a registered broker-dealer for those entities that are not currently parties to a networking arrangement or registered as broker-dealers and that intend to distribute indexed annuities that are registered as securities;[233] (v) loss of revenue to insurance companies that determine to cease issuing indexed annuities; and (vi) diminished competition that may result.

Some commenters opined that the benefits of the proposal to indexed annuity

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232 The $642,275 cost was derived by dividing the total annual cost savings for all insurance companies that we believe will be entitled to the rule 12h-7 exemption ($15,414,600) by the number of such companies (24). See supra text accompanying notes 228 and 230.

233 While some distributors may register as broker-dealers or cease distributing indexed annuities that will be required to be registered as a result of rule 151A, based on our experience with insurance companies that issue insurance products that are also securities, we believe that the vast majority will continue to distribute those indexed annuities via networking arrangements with registered broker-dealers, as discussed below.

purchasers would outweigh any costs to the indexed annuity industry.[234] One commenter, for example, recognized that the proposal would impose some compliance costs on the indexed annuity industry, but stated that these costs are minimal relative to the gains to investors in regulatory oversight.[235] The commenter stated that the rule would bring clarity regarding the status of indexed annuities under the federal securities laws and would subject indexed annuity sales to the application of suitability and antifraud protections under the federal securities laws.

A number of other commenters, however, stated that the Commission significantly underestimated the costs of the proposal.[236] As discussed below, these commenters stated that the proposal would impose substantial costs throughout the industry, affecting insurers, agents, marketing organizations. Commenters also stated that consumers would face additional costs as a result of the proposal, as the costs of product development and offering and selling registered securities are passed on to consumers. [237] We also received a number of comments specifically stating that the proposal would have an adverse impact on small entities, such as small insurance distributors.[238]

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234 See, e.g., Cornell Letter, supra note 7; NASAA Letter, supra note 133.

235 Cornell Letter, supra note 7.

236 See, e.g., Allianz Letter, supra note 54; ACLI Letter, supra note 94; American Equity Letter, supra note 54; Coalition Letter, supra note 54; Old Mutual Letter, supra note 54; Second Aviva Letter, supra note 54. Southwest Letter, supra note 136; Transamerica Letter, supra note 54.

237 See, e.g., American National Letter, supra note 54; National Western Letter, supra note 54; Old Mutual Letter, supra note 54; Southwest Letter, supra note 136.

238 See infra Section VII.

The following is a more detailed discussion of specific costs that we believe will be associated with the rule. We specifically identified and discussed each of these costs in the Proposing Release. We received comments on each identified cost.

Determination Under Rule 151A

Insurers may incur costs in performing the analysis necessary to determine whether amounts payable under an indexed annuity would be more likely than not to exceed the amounts guaranteed under the contract. This analysis calls for the insurer to analyze expected outcomes under various scenarios involving different facts and circumstances. Insurers routinely undertake such analyses for purposes of pricing and valuing their contracts.[239] As a result, we believe that the costs of undertaking the analysis for purposes of the rule may not be significant. However, the determinations necessary under the rule may result in some additional costs for insurers that issue indexed annuities, either because the timing of the determination does not coincide with other similar analyses undertaken by the insurer or because the level or type of actuarial and legal analysis that the insurer determines is appropriate under the rule is different or greater than that undertaken for other purposes, or for other reasons. These costs, if any, could include the costs of software, as well as the costs of internal personnel and external consultants (e.g., actuarial, accounting, legal).

Several commenters who issue indexed annuities disputed that insurers undertake these analyses.[240] Other commenters, however, confirmed that these analytical methods

239 See generally Black and Skipper, supra note 39, at 26-47, 890-99.

240 See, e.g., American Equity Letter, supra note 54; National Western Letter, supra note 54; Sammons Letter, supra note 54. The commenters did not provide cost estimates for performing the analysis necessary under the rule.

exist and are used by insurers for internal purposes.[241] We continue to believe that because insurers routinely undertake these types of analyses, the costs of doing so for purposes of the rule may not be significant.

Securities Act Registration Statements

As noted above, we believe that significant benefits arise from the registration of indexed annuities, including enhanced disclosures of critical information regarding these products. Without such disclosure, investors face significant obstacles in making informed investment decisions with regard to purchasing indexed annuities that expose investors to securities investment risk. Investors in indexed annuities are confronted with many of the same risks and benefits that other securities investors are confronted with when making investment decisions. Extending the federal securities disclosure regime to indexed annuities that impose investment risk should help to provide investors with the information they need. The costs of preparing and filing registration statements are not unique to indexed annuities that are outside the scope of the Section 3(a)(8) exemption for annuities as a result of rule 151A, but apply to all issuers of registered securities. However, we are sensitive to these costs and discuss them below, along with comments that we received on this analysis.

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241 See, e.g., Aviva Letter, supra note 54; Academy Letter, supra note 54. We give substantial weight to the views of the Academy on this point, given their expertise in this type of analysis, and are not persuaded that the contrary comments of several issuers are representative of industry practice. See BLACK'S LAW DICTIONARY 39 (8th ed. 2004) (An actuary is a statistician who determines the present effects of future contingent events and who calculates insurance and pension rates on the basis of empirically based tables.); American Academy of Actuaries, Mission, available at: http://www.actuary.org/mission.asp (The mission of the Academy is to, among other things, provide independent and objective actuarial information, analysis, and education for the formation of sound public policy.).

Insurers will incur costs associated with preparing and filing registration statements for indexed annuities that are outside the insurance exemption as a result of rule 151A. These include the costs of preparing and reviewing disclosure, filing documents, and retaining records. Our Office of Economic Analysis has considered the effect of the rule on indexed annuity contracts with typical terms and has determined that, more likely than not, these contracts would not meet the definition of "annuity contract" or "optional annuity contract" if they were issued after the effective date of the rule. For purposes of the PRA, we have estimated an annual increase in the paperwork burden for companies to comply with the rules to be 60,000 hours of in-house company personnel time and $72,000,000 for services of outside professionals.[242] We estimate that the additional burden hours of in-house company personnel time will equal total internal costs of $10,500,000[243] annually, resulting in aggregate annual costs of $82,500,000[244] for in-house personnel and outside professionals. These costs reflect the assumption that filings will be made on Form S-1 for 400 contracts each year, which we made for purposes of the PRA.

As indicated in our analysis for purposes of the PRA, we received several comments questioning our estimate of the costs of registering an indexed annuity on

242 See supra Part IV.C.

243 This cost increase is estimated by multiplying the total annual hour burden (60,000 hours) by the estimated hourly wage rate of $175 per hour. Consistent with recent rulemaking releases, we estimate the value of work performed by the company internally at a cost of $ 175 per hour.

244 $10,500,000 (in-house personnel) + $72,000,000 (outside professionals).

Form S-1.[245] One commenter stated that, for insurers that have not previously prepared a Form S-1 registration statement, external legal costs could be as high as $250,000-$500,000 for each registration statement.[246] However, the commenter did not specify the source of this range of cost estimates or how it was made. The $250,000-$500,000 range cited by the commenter is for an issuer that has not previously filed a Form S-1, with the commenter acknowledging that the costs to an experienced filer would be lower (as low as $50,000 to $100,000).[247] Another commenter estimated external legal costs for preparation and filing of a Form S-1 registration statement with the SEC at $350,000 for the first few years, which, the commenter stated, would decrease over time as the insurer gained more expertise.[248] Our average $180,000 estimate reflects outside professional costs incurred not only by first-time Form S-1 filers, but also the costs of preparing Form S-1 for contracts offered by experienced Form S-1 filers, as well as annual updates to existing Form S-1 registration statements, which we expect to be significantly lower than costs incurred by first-time filers. Therefore, we do not believe that it is necessary to change our estimate of outside professional costs based on the commenters' estimated costs.

One commenter cites a cost of $62,500 per insurance company for "Registration Statement Preparation" but also appears to assume a cost of $255,000 per contract for

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245 See, e.g., Allianz Letter, supra note 54; Second Aviva Letter, supra note 54; Second NAFA Letter, supra note 191.

246 Allianz Letter, supra note 54.

247 Id.

248 Second Aviva Letter, supra note 54.

registration statement preparation.[249] It is unclear how these estimates should be reconciled, and we are not revising our estimate of the burden of preparation of registration statement on the basis of the commenter's estimates.

Another commenter stated that the Commission's estimate of outside professional costs of $400 per hour does not reflect market rates for securities counsel.[250] However, the commenter did not cite a different rate and did not explain the basis for its disagreement with the $400 per hour rate cited by the Commission. Our estimate of $400 per hour for outside professionals retained by the issuer is consistent with recent rulemakings and is based on discussions between our staff and several law firms.[251] Accordingly, we are not changing our estimate of the cost per hour of outside professional costs.

The commenter further stated that the estimates of time involved are low for persons unfamiliar with the process of registration of securities under the federal securities laws and the anticipated need for interaction with Commission staff. However, our estimate of time required to prepare a registration statement reflects time needed not only by first-time Form S-1 filers, but also the time involved in preparing Form S-1 for contracts offered by experienced S-1 filers, as well as annual updates to the existing Form S-1 registration statement, which we expect to be significantly less than time needed by first-time filers. Therefore, we are not revising our estimate of time involved in preparing registration statements on Form S-1.

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249 Second NAFA Letter, supra note 191.

250 Transamerica Letter, supra note 54.

251 See, e.g., Securities Act Release No. 8909 (Apr. 10, 2008) [73 FR 20512, 20515 (Apr. 15, 2008)] ("Revisions to Form S-11 Release").

Commenters stated that insurers will be subject to significant additional costs as a result of having to register on Form S-1.[252] These include required registration fees for securities sold. One commenter estimated Commission registration fees, assuming sales of $5 billion annually, as $196,500.[253] Commenters also stated that the due diligence necessary to verify disclosures in the registration statement will require significant resources.[254] We acknowledge that these are additional costs associated with registration. However, these costs are not unique to indexed annuities, but are incurred by all issuers of registered securities.

Commenters also cited other costs of registration on Form S-1, such as preparation of financial statements in accordance with generally accepted accounting principles ("GAAP"), which, according to the commenters, many insurers currently do not do.[255] One commenter estimated a cost of at least several million dollars for an insurer to develop GAAP financial statements.[256] We acknowledge that if an indexed annuity issuer that did not currently prepare GAAP financial statements were required to do so in order to register its indexed annuities, the one-time start-up costs could be significant. We note that, during the two-year transition period for rule 151A, the Commission intends to consider how to tailor accounting requirements for indexed

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252 See, e.g., Allianz Letter, supra note 54; American Equity Letter, supra note 54; Old Mutual Letter, supra note 54; Transamerica Letter, supra note 54.

253 Allianz Letter, supra note 54.

254 National Western Letter, supra note 54; Old Mutual Letter, supra note 54.

255 See, e.g., Allianz Letter, supra note 54. See Second Aviva Letter, supra note 54.

256 Second Aviva Letter, supra note 54.

annuities.[257]

Based on the foregoing analysis, our estimates of the costs of registration for indexed annuities include the costs of preparing Form S-1 registration statements, totaling \$82,500,000 annually, or \$206,250 per contract, and, based on a commenter's estimate, registration fees of \$196,000 assuming sales by an insurer of \$5 billion annually. If the insurer does not already prepare financial statements in accordance with GAAP, the insurer will also incur costs of developing GAAP financials, which one commenter estimated to involve one-time start-up costs of at least several million dollars per insurer. Commenters also mentioned due diligence as a cost of registration, but did not separately break out its cost.

Costs of Printing Prospectuses and Providing them to Investors

Insurers will incur costs to print and provide prospectuses to investors for indexed annuities that are outside the insurance exemption as a result of rule 151A. For purposes of the PRA, we have estimated that registration statements will be filed for 400 indexed annuities per year. In the Proposing Release, we estimated that it would cost \$0.35 to print each prospectus and \$1.21 to mail each prospectus,[258] for a total of \$1.56 per

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257 See supra note 95 and accompanying text.

258 These estimates reflect estimates provided to us by Broadridge Financial Solutions, Inc. ("Broadridge"), in connection with our recent proposal to create a summary prospectus for mutual funds. The estimates depend on factors such as page length and number of copies printed and not on the content of the disclosures. Because we believe that these factors may be reasonably comparable for indexed annuity and mutual fund prospectuses, we believe that it is reasonable to use these estimates in the context of indexed annuities. See Memorandum to File number S7-28-07 regarding October 27, 2007 meeting between Commission staff members and representatives of Broadridge Financial Solutions, Inc. (Nov. 28, 2007) ("Broadridge Memo"). The memorandum is available for inspection and copying in File No. S7-28-07 in the Commission's Public Reference Room and on the Commission's Web site at http://www.sec.gov/comments/s7-28-07/s72807-5.pdf.

prospectus. These estimates would be reduced to the extent that prospectuses are delivered in person or electronically, or to the extent that Securities Act prospectuses are substituted for written materials used today, rather than being delivered in addition to those materials.

One commenter questioned whether the cost of printing an indexed annuity prospectus on Form S-1 would be roughly equivalent to that of printing a mutual fund prospectus on Form N-1A, as we were assuming for purposes of our estimate in the proposing release.[259] The commenter, based on its internal projections of prospectus printing and mailing costs, stated that the indexed annuity prospectus would cost twice as much as the mutual fund prospectus. The commenter estimated printing costs for an indexed annuity prospectus on Form S-1 as $1.50 and the cost of mailing as $1.38 for a total cost of $2.88. In making its cost projections, the commenter assumed that the mutual fund prospectus would be 25 pages long, while the indexed annuity prospectus (including financial statements) would be 100 pages long. Our estimate of the cost of printing and mailing a mutual fund prospectus was based on an assumed page length of 45 pages.[260] We believe that the commenter's estimate of page length may be more realistic for a prospectus prepared on Form S-1.[261] Accordingly, we are revising our estimate of the costs of printing and mailing the prospectus to the costs cited by the

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259 Allianz Letter, supra note 54.

260 Broadridge Memo, supra note 258.

261 See Pre-effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File No. 333-132399) (filed Feb. 7, 2007) (67-page prospectus); 257 Pre-effective Amendment No. 1 to Registration Statement on Form S-1 of Golden America Life Insurance Company (File No. 333-67660) (filed Feb. 8, 2002) (170-page prospectus).

commenter; i.e., $1.50 for printing the prospectus and $1.38 for mailing for a total cost of $2.88.[262] Though we have revised our estimate as described above, we believe that the revised estimate is conservative because some indexed annuity issuers who file Exchange Act reports and incorporate their financial statements from their Exchange Act reports by reference may have significantly shorter prospectuses as a result.[263]

Another commenter estimated the cost per insurance company of "printing prospectuses/supply chain"[264] at $20,000 per insurance company for a combined total of $880,000. The commenter does not explain how it arrived at this estimate. Moreover, because the commenter's estimate is for total cost per insurance company and does not specify the number of prospectuses printed by each insurance company, and our estimate is a per prospectus cost, we are not able to compare the two estimates. Thus, we are not revising our estimate of the cost of printing prospectuses and providing them to investors.

Networking Arrangements with Registered Broker-Dealers and Other Related Costs

Rule 151A may impose costs on indexed annuity distributors that are not currently parties to a networking arrangement or registered as broker-dealers. These costs are not unique to indexed annuity distributors but apply to all distributors of

262 Allianz Letter, supra note 54. This revision does not affect our estimate of the cost burden for Form S-1 under the Paperwork Reduction Act. Printing and mailing costs are not "collections of information" for purposes of the Paperwork Reduction Act.

263 See Pre-effective Amendment No. 4 to Registration Statement on Form S-1 of PHL Variable Insurance Company (File No. 333-132399) (filed Feb. 7, 2007) (20 pages of the prospectus are attributable to financial statements); Pre-effective Amendment No. 1 to Registration Statement on Form S-1 of Golden America Life Insurance Company (File No. 333-67660) (filed Feb. 8, 2002) (63 pages of the prospectus are attributable to financial statements).

264 Second NAFA Letter, supra note 191. It is not fully clear what the commenter intends by "supply chain," but we are citing the estimate, because it references printing of prospectuses.

federally registered securities that are not registered broker-dealers. While these entities may choose to register as broker-dealers, in order to continue to distribute indexed annuities that are registered as securities, these distributors will likely enter into a networking arrangement with a registered broker-dealer. Under these arrangements, an affiliated or third-party broker-dealer provides brokerage services for an insurance agency's customers, in connection with transactions in insurance products that are also securities. Entering into a networking arrangement will impose costs associated with contracting with the registered broker-dealer regarding the terms, conditions, and obligations of each party to the arrangement. We anticipate that a distributor will incur legal costs in connection with entering into a networking arrangement with a registered broker-dealer, as well as ongoing costs associated with monitoring compliance with the terms of the networking arrangement. However, while there are costs of entering into a networking arrangement and monitoring compliance with the terms of the arrangement, distributors in networking arrangements will not be subject to the full range of costs associated with obtaining and maintaining broker-dealer registration.

One commenter estimated that the cost of registering as a broker-dealer, taking into account only the legal and regulatory work of initial setup,[265] licensing, and staffing could be between $250,000-$500,000.[266] Another commenter estimated the cost of

265 Allianz Letter, supra note 54. Initial setup includes registering the broker-dealer with the Commission, developing extensive written policies and procedures tailored to its business, obtaining a fidelity bond, registering its offices as branch offices, and setting up a procedure for a principal review of all applications, as well as review of advertisements, business cards, letterhead, office signage, correspondence, and e-mails.

266 Allianz Letter, supra note 54.

forming a registered broker-dealer at $800,000.[267] The same commenter cites a cost of $3 million for "BD startup" in a separate comment.[268] As we discuss above, however, we believe it is more likely that distributors will enter into networking arrangements with registered broker-dealers, rather than register as broker-dealers.

Some commenters disagreed that distributors would enter into networking arrangements with registered broker-dealers, stating that the cost of networking would be too high.[269] One of these commenters stated that networking would be inordinately expensive.[270] The commenter stated that under current industry practice, a distributor would bear expenses when using a networking arrangement that include examination fees, state registration fees, and possibly a pro rata share of the associated broker-dealer's increased compliance costs, and would have to share a portion of his commissions with the registered broker-dealer.[271] Commenters did not provide estimates of the cost of

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267 Memorandum from the Division of Investment Management Regarding a November 10, 2008 Meeting with Representatives of the National Association for Fixed Annuities (Nov. 26, 2008). One commenter stated that the costs of registering and operating as a broker-dealer include FINRA registration and examination fees of up to $4,000. The commenter further stated that the legal cost associated with registering and applying for membership with FINRA, the cost of completing the necessary forms, and the costs of ongoing compliance could result in start-up costs of $25,000 and between $50,000 to $100,000 annually to maintain the registration. Coalition Letter, supra note 54.

268 Second NAFA Letter, supra note 191.

269 See, e.g., American Equity Letter, supra note 54; Coalition Letter, supra note 54.

270 Coalition Letter, supra note 54.

271 Coalition Letter, supra note 54. One commenter indicated its belief that insurance agencies are only permitted to enter into networking arrangements with affiliated broker-dealers. Therefore, the commenter stated that insurance agencies without an affiliated broker-dealer would not appear to be able to take advantage of networking arrangements. We disagree with the commenter's interpretation and note that, in our view, insurance agencies may enter into networking arrangements with unaffiliated broker-dealers.

networking. We recognize that a distributor will incur costs in entering into networking arrangement. We estimate the upper bound of entering into a networking agreement to be the equivalent of the cost of establishing a registered broker-dealer. Commenters provided a range of cost estimates for establishing a registered broker-dealer from $250,000 to $3 million. However, these costs are not unique to indexed annuities. For example, issuers of insurance products registered as securities, such as variable annuities, may incur networking costs, as do banks involved in networking arrangements. Moreover, while we would expect networking to be generally more cost-effective than registration as a broker-dealer, to the extent that it is not, broker-dealer registration remains an option for indexed annuity distributors.

Commenters also cited additional costs that agents will incur as a result of the rule.[272] For example, commenters cited annual securities registration and licensing fees, including FINRA fees and state securities fees, that agents would be required to pay. With regard to state registration fees, one commenter estimated that an agent selling in all 50 states would pay approximately $3,100 in initial state securities registration fees and nearly $3,000 annually in ongoing state securities fees.[273] We recognize that agents may incur additional registration and licensing costs and are sensitive to the impact of such costs. However, these fees are paid by all sellers of securities and are not unique to those selling indexed annuities. The fees are a product of the regulatory structure mandated by Congress under the federal securities laws, which is intended to provide sales practice

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272 See, e.g., Allianz Letter, supra note 54; Coalition Letter, supra note 54; Southwest Letter, supra note 136.

273 Allianz Letter, supra note 54.

and other protections to investors.

Several commenters cited an industry source that estimated loss to distributors as a result of the rule as approximately $800 million.[274] This source estimates that agents would lose about $200 million in income by having to share commissions with the broker-dealers with which the agent is associated. The source estimates that fees charged by the broker-dealer and by FINRA would amount to another $22.5 million. The sharing of commissions, as well as the fees charged by the broker-dealer and by FINRA are necessary expenses of selling registered securities. For marketing organizations, the source estimates that indexed annuity sales would drop by 60% and marketing organization compensation would be reduced from around $500 million-$700 million a year today to $60 million-$200 million as a result of the rule. However, the source does not explain the basis for the estimate of the decline in sales. Moreover, if the marketing organization registers as, or enters into a networking arrangement with, a broker-dealer, it would have opportunities to sell other types of securities, and may be able to compensate for any declines in sales of indexed annuities that may occur. We believe that even at the high end of costs suggested by commenters, given the imperative of the federal securities laws and the size of the industry, these costs are nonetheless justified.

Possible Loss of Revenue

Insurance companies that determine that indexed annuities are outside the

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274 Letter of Advisors Excel (Aug. 20, 2008); Coalition Letter, supra note 54; Letter of Courtney A. Juhl (Aug. 15, 2008), citing Jack Marrion, The Proposed Rule Will Sock it to Index Annuity Distributors, NATIONAL UNDERWRITER LIFE & HEALTH/FINANCIAL SERVICES EDITION, Aug. 4, 2008, at 13, available at: http://www.lifeandhealthinsurancenews.com/cms/nulh/Weekly%20Issues/issues/2008/29/Focus/L29cover2.

insurance exemption under rule 151A could either choose to register those annuities under the Securities Act or to cease selling those annuities. If an insurer ceases selling such annuities, the insurer may experience a loss of revenue. Commenters agreed that some insurers may stop selling indexed annuities as a result of the rule and that they would experience a loss of revenue.[275] One commenter estimated a total first year loss to insurance companies of approximately $300,000,000 as a result of the rule.[276] The commenter argued that industry experts state indexed annuity sales will drop from approximately $30 billion of premium per year (projected for 2008) to $10 billion per year as a result of the rule.[277] However, the commenter does not explain how this estimate was determined. We believe that even at the high end of costs suggested by commenters, given the imperative of the federal securities laws and the size of the industry, these costs are nonetheless justified.

The amount of lost revenue for insurance companies would depend on actual revenues prior to effectiveness of the rules and to the particular determinations made by insurers regarding whether to continue to issue registered indexed annuities. However, the loss of revenue may be offset, in whole or in part, by gains in revenue from the sale of other financial products, as purchasers' need for financial products will not diminish. These gains could be experienced by the same insurers who exit the indexed annuity business or they could be experienced by other insurance companies or other issuers of

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275 See, e.g., Allianz Letter, supra note 54; National Western, supra note 54.

276 Second NAFA Letter, supra note 191.

277 Id., citing "The Advantage Compendium, Jack Marrion, President." The commenter does not provide a specific citation, and we have been unable to find the source of the estimate provided by the commenter.

securities or other financial products.

Commenters also stated that sellers of indexed annuities may lose revenue because rule 151A may cause them to cease selling these products.[278] One commenter estimated a first-year income loss to distributors of $1.5 billion, based on an estimated decline in indexed annuity sales from approximately $30 billion (projected for 2008) to $10 billion per year, as a result of the rule.[279]

The amount of lost revenue for sellers of indexed annuities would depend on actual revenues prior to effectiveness of the rules and to the particular determinations made by distributors regarding whether to continue to sell registered indexed annuities. The loss of revenue may be offset, in whole or in part, by gains in revenue from the sale of other financial products, as purchasers' need for financial products will not diminish.

Commenters also cited indirect or collateral costs associated with the rule.[280] For example, if insurers exit the indexed annuities business; this will result in a reduction in personnel of those who are no longer needed to administer the products.[281] Commenters also stated that if insurers chose to stop offering indexed annuities because of the rule, third-party service providers who helped support the administration and/or sale of the insurer's indexed annuities may also incur costs.[282]

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278 See, e.g., Second Old Mutual Letter, supra note 76; Southwest Letter, supra note 136.

279 Second NAFA Letter, supra note 191. This commenter also estimated a first-year income loss of $300 million for independent marketing organizations.

280 Allianz Letter, supra note 54; Aviva Letter, supra note 54; National Western Letter, supra note 54.

281 See, e.g., Allianz Letter, supra note 54.

282 See, e.g., Allianz Letter, supra note 54.

A number of commenters cited job loss as a consequence of the rule. Loss of employment, these commenters argued, would affect current employees of insurance companies, agents, and others.[283] Demand for financial products is relatively fixed in the aggregate. Within the insurance industry, some employees of insurance companies and agents will likely find employment in other areas of the insurance industry.

Possible Diminished Competition

There could be costs associated with diminished competition as a result of our rules. In order to issue indexed annuities that are outside the insurance exemption under rule 151A, insurers would be required to register those annuities as securities. If some insurers determine to cease issuing indexed annuities rather than undertake the analysis required by rule 151A and register those annuities that are outside the insurance exemption under the rule, there will be fewer issuers of indexed annuities, which may result in reduced competition. Any reduction in competition may affect investors through potentially less favorable terms of insurance products and other financial products, such as increases in direct or indirect fees. A number of commenters agreed that diminished competition would result in indexed annuity purchasers receiving less favorable terms. However, the commenters did not provide data in this regard.[284]

It is currently unknown whether new providers will enter the market for indexed annuities. We note, however, that the possibility for new entrants created by this rule is

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283 E.g., Letter of Todd F. Gregory (Aug. 5, 2008); Letter of Terry R. Lucas (Sept. 9, 2008); National Western Letter, supra note 54; Letter of Randall L. Whittle (Aug. 8, 2008).

284 See, e.g., American Equity, supra note 54; American National, supra note 54; National Western, supra note 54.

beneficial to competition, even if they do not enter the market. If the indexed annuity market becomes sufficiently uncompetitive and economic profits increase, new entrants will likely arrive, putting downward pressure on prices. Thus, any reduction in regulatory barriers to entry created by increased regulatory certainty can have the effect of increasing competition and reducing prices, a direct benefit to investors. It is currently unknown whether new providers will enter the market for indexed annuities. We note, however, that the possibility for new entrants created by this rule is beneficial to competition, even if they do not enter the market. If the indexed annuity market becomes sufficiently uncompetitive and economic profits increase, new entrants will likely arrive, putting downward pressure on prices. Thus, any reduction in regulatory barriers to entry created by increased regulatory certainty can have the effect of increasing competition and reducing prices, a direct benefit to investors.

Additional Costs

Commenters provided further information on costs for insurance companies. One commenter estimated a total first-year cost to insurance companies of \$237,000,000.[285] Components of this cost are identified as broker-dealer startup, broker-dealer annual maintenance, new compliance costs, legal start-up costs, FINRA implementation, FINRA maintenance, state fees, Form S-1 fees, including registration statement preparation, state filing, annual audit, operations/administration/systems, printing prospectus supply chain, and additional fees paid to FINRA impacting product pricing. Much of these costs appear to be the attributable to setting up a broker-dealer. As note above, however, we do not believe that insurers would need to establish a broker-dealer to continue to sell

[285] Second NAFA Letter, supra note 191.

indexed annuities. An insurer could make use of existing broker-dealers and avoid the costs of starting a broker-dealer. If those costs are avoided, the commenter's estimate could be reduced by at least $135,727,000 (the total cost attributable to the costs of starting a broker-dealer as estimated by the commenter). This still leaves a total first-year cost to insurance companies of over $100,000,000. We recognize this is a substantial cost. However, these costs are not unique to indexed annuities but are the costs of offering and selling any registered securities. All issuers of securities must incur such costs, and issuers of indexed annuities will not incur higher costs as a result of the rule than any other issuer of securities.

One commenter cited the cost that may be incurred if the insurer needs to find additional distributors as a result of existing distributors dropping out of the indexed annuity market because of the costs they would incur under the rule.[286] However, this is no different from any securities issuer, all of whom must use distribution channels subject to the federal securities laws.

The Commission has carefully considered the costs cited by the commenters. These include the costs that the commenters state will be incurred by insurers, distributors, and agents. We have also considered the collateral costs cited by the commenters, and the possibility of loss of employment cited by the commenters. While we have taken the costs of the rule into account, we also continue to believe that the rule will result in substantial benefits to indexed annuity purchasers, in the form of enhanced disclosure and sales practice protections, greater regulatory certainty for issuers and sellers of indexed annuities, enhanced competition, and relief from reporting obligations.

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286 See, e.g., American Equity Letter, supra note 54.

While the costs of the rule may be significant, where an annuity contract is not entitled to the Section 3(a)(8) exemption, which we have concluded is the case with respect to certain indexed annuities, the federal securities laws apply, and participants in the indexed annuity market will need to bear the costs of compliance with the federal securities laws, as do any other participants in the securities markets. Furthermore, notwithstanding these costs, our rule imposes no greater costs than those imposed on other market participants who issue or sell securities.

VI. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION; CONSIDERATION OF BURDEN ON COMPETITION

Section 2(b) of the Securities Act[287] and Section 3(f) of the Securities Exchange Act[288] require the Commission, when engaging in rulemaking that requires it 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. Section 23(a)(2) of the Exchange Act[289] 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.

A. Efficiency

For the following reasons, we believe that rule 151A will promote efficiency by

287 15 U.S.C. 77b(b).

288 15 U.S.C. 78c(f).

289 15 U.S.C. 78w(a)(2).

extending the benefits of the disclosure and sales practice protections of the federal securities laws to indexed annuities that are more likely than not to provide payments that vary with the performance of securities.

The required disclosures will enable investors to make more informed investment decisions. As discussed above, disclosures that will be required for registered indexed annuities include information about costs (such as surrender charges); the method of computing indexed return (e.g., applicable index, method for determining change in index, caps participation rates, spreads); minimum guarantees, as well as guarantees, or lack thereof, with respect to the method for computing indexed return; and benefits (lump sum, as well as annuity and death benefits). This information will be public and accessible to all investors, intermediaries, third party information providers, and others through the SEC's EDGAR system. Public availability of this information will be helpful to investors in making informed decisions about purchasing indexed annuities. The enhancement of investor decision-making that will result from the public availability of information about indexed annuities will ultimately lead to more efficient capital allocation in the securities markets.

Investors will also receive the benefits of the sales practice protections, including a registered representative's obligation to make only recommendations that are suitable. Under the federal securities laws, persons effecting transactions in indexed annuities that fall outside the insurance exemption under rule 151A will be required to be registered broker-dealers or become associated persons of a broker-dealer. As a result, investors who purchase these indexed annuities after the effective date of rule 151A will receive the benefits associated with a registered representative's obligation to make only recommendations that are suitable. The registered representatives who sell registered indexed annuities will be subject to supervision by the broker-dealer with which they are associated. Both the selling broker-dealer and its registered representatives will be subject to the oversight of FINRA. The registered broker-dealers will also be required to comply with specific books and records, supervisory, and other compliance requirements under the federal securities laws, as well as be subject to the Commission's general inspections and, where warranted, enforcement powers. These sales practice protections will promote suitable recommendations to investors, which will lead to enhanced decision-making by investors and, ultimately, to greater efficiency in the securities markets.

Some commenters argued that rule 151A, as proposed, would not promote efficiency, because it would be duplicative of state insurance regulation of indexed annuities.[290] These commenters argued that disclosure and suitability concerns in connection with indexed annuity sales are already addressed by state insurance regulation, and further indicated that state insurance regulation is more closely tailored to indexed annuities than federal securities regulation.

We do not believe that these efforts, no matter how strong, can substitute for the federal securities law protections that apply to instruments that are regulated as securities. The federal securities laws were designed to provide uniform protections, with respect to both disclosure and sales practices, to investors in securities. State insurance laws,

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290 See e.g., Coalition Letter, supra note 54; NAFA Letter, supra note 54. But see Washington State Letter, supra note 199 (noting its experience with variable annuities and synergy of complementary regulation by the insurance regulator focused on solvency and the securities regulator focused on investor protection).

enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws. Indeed, at least one state insurance regulator acknowledged the developmental nature of state efforts and the lack of uniformity in those efforts.[291] Where the purchaser of an indexed annuity assumes the investment risk of an instrument that fluctuates with the securities markets, and the contract therefore does not fall within the Section 3(a)(8) exemption, the application of state insurance regulation, no matter how effective, is not determinative as to whether the contract is subject to the federal securities laws, which provide uniform and enforceable protections for investors. In addition, during the transition period between adoption and the effective date of rule 151A, we intend to consider how to tailor disclosure requirements for indexed annuities.

One commenter stated that the Commission cannot claim further efficiencies without a comprehensive consideration of the existing state law regulatory regime, the efficiencies that regime already realizes, and the respects in which that state regime falls short and further gains may be achieved by the Commission.[292] The commenter further stated that the proposal would only impose further costs and burdens on efficiency with no compensating benefit, adding an unnecessary, largely duplicative layer of federal requirements that were developed for securities and have not been tailored to annuity

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291 See Voss Letter, supra note 13 (proposing to accelerate NAIC efforts to strengthen the NAIC model laws affecting indexed annuity products and urge adoption by more of the member states).

292 Coalition Letter, supra note 54.

products and purchasers generally.[293] We disagree that the Commission must undertake a comprehensive consideration of the existing state law regulatory regime and that there are no benefits from the federal securities laws. Congress has determined that securities investors are entitled to the disclosure, antifraud, and sales practice protections of the federal securities laws. The burdens that are uniformly imposed on issuers and sellers of all types of securities are part of those laws, and it is not the Commission's role to reevaluate the efficiencies of that regulatory structure for each particular instrument that is a security.

B. Competition

We also anticipate that, because rule 151A will improve investors' ability to make informed investment decisions, it will lead to increased competition between issuers and sellers of indexed annuities, mutual funds, variable annuities, and other financial products, and increased competitiveness in the U.S. capital markets. The greater clarity that results from rule 151A also may enhance competition because insurers who may have been reluctant to issue indexed annuities, while their status was uncertain, may decide to enter the market. Similarly, registered broker-dealers who currently may be unwilling to sell unregistered indexed annuities because of their uncertain regulatory status may become willing to sell indexed annuities that are registered, thereby increasing competition among distributors of indexed annuities.

We have carefully considered the concerns raised by commenters, and we continue to believe that rule 151A will greatly enhance disclosures regarding indexed annuities. In addition to the specific benefits described above, we anticipate that these

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293 Id.

enhanced disclosures will also benefit the overall financial markets and their participants.

We anticipate that the disclosure of terms of indexed annuities will be broadly beneficial to investors, enhancing the efficiency of the market for indexed annuities through increased competition. Disclosure will make information on indexed annuity contracts, including terms, publicly available. Public availability of terms will better enable investors to compare indexed annuities and may focus attention on the price competitiveness of these products. It will also improve the ability of third parties to price contracts, giving purchasers a better understanding of the fees implicit in the products. We anticipate that third-party information providers may provide services to price or compare terms of different indexed annuities. Analogously, we note that public disclosure of mutual fund information has enabled third-party information aggregators to facilitate comparison of fees.[294] We believe that increasing the level of price transparency and the resulting competition through enhanced disclosure regarding indexed annuities would be beneficial to investors. It could also expand the size of the market, as investors may have increased confidence that indexed annuities are competitively priced.

The Commission believes that there could be costs associated with diminished competition as a result of rule 151A. As the commenters note, some insurance companies may stop issuing indexed annuities, and some broker-dealers and agents may determine not to sell indexed annuities. We recognize that the impact of rule 151A on competition may be mixed, but, on balance, we continue to believe that rule 151A will

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294 See, e.g., FINRA, Fund Analyzer, available at: http://www.finra.org/fundanalyzer ("FINRA Fund Analyzer").

provide the benefits described above and has the potential to increase competition. In this regard, the demand for financial products is relatively fixed, in the aggregate. Any potential reduction in indexed annuities sold under the rule would likely correspond with an increase in the sale of other financial products, such as mutual funds or variable annuities. Thus, total reductions in competition may not be significant, when effects on the financial industry as a whole, including insurance companies together with other providers of financial instruments, are considered. Within the insurance industry, if some insurers cease selling indexed annuities, it is also likely that these insurers will sell other products through the same distribution channels, such as annuities with fixed interest rates.

We conclude, in any event, that the importance of providing the protections of the federal securities laws to indexed annuity purchasers is significant notwithstanding any burden on competition that may result from the operation of the rule. In addition, the rule will provide other benefits. It will bring about clarity in what has been an uncertain area of law. In addition, issuers and sellers of these products will no longer be subject to uncertainty and litigation risk with respect to the laws that are applicable.

Some commenters argued that regulation under the federal securities laws of indexed annuities will place them at a competitive disadvantage to variable annuities and mutual funds because the Commission's disclosure scheme is not tailored to these contracts.[295] Commenters cited a number of supposed defects, including the lack of a registration form that is well-suited to indexed annuities, questions about the appropriate

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295 Allianz Letter, supra note 54; Sammons Letter, supra note 54; Second Aviva Letter, supra note 54.

method of accounting to be used by insurance companies that issue indexed annuities, and concerns about parity of the registration process vis-a-vis mutual funds.

We acknowledge that, as a result of indexed annuity issuers having historically offered and sold their contracts without complying with the federal securities laws, the Commission has not created specific disclosure requirements tailored to these products. This fact, though, is not relevant in determining whether indexed annuities are subject to the federal securities laws. The Commission has a long history of creating appropriate disclosure requirements for different types of securities, including securities issued by insurance companies, such as variable annuities and variable life insurance.[296] We note that we are providing a two-year transition period for rule 151A, and, during this period, we intend to consider how to tailor disclosure requirements for indexed annuities. We encourage indexed annuity issuers to work with the Commission during that period to address their concerns.

One commenter indicated that the rule creates a competitive disadvantage for indexed annuities to the advantage of fixed annuities and suggests that that the Commission improperly failed to consider competition between indexed and fixed annuities.[297] Fixed annuities do not involve assumption of significant investment risks by purchasers. By contrast, indexed annuities that fall outside the insurance exemption under rule 151A do impose significant investment risk on purchasers, and, like other securities, they require the protections of the federal securities laws. Securities and non-

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296 See Form N-4 [17 CFR 239.17b and 274.11c] (registration form for variable annuities); Form N-6 [17 CFR 239.17c and 274.11d] (registration form for variable life insurance).

297 NAFA Letter, supra note 54.

securities are subject to different regulatory regimes as a result of Congressional action; it is not the Commission's role to revisit that determination by Congress.

C. Capital Formation

We also anticipate that the increased market efficiency resulting from enhanced investor protections under rule 151A could promote capital formation by improving the flow of information among insurers that issue indexed annuities, the distributors of those annuities, and investors. Public availability of this information will be helpful to investors in making informed decisions about purchasing indexed annuities. The information will enhance investors' ability to compare various indexed annuities and also to compare indexed annuities with mutual funds, variable annuities, and other securities and financial products. The potential liability for materially false and misleading statements and omissions under the federal securities laws will provide additional encouragement for accurate, relevant, and complete disclosures by insurers that issue indexed annuities and by the broker-dealers who sell them.[298]

Some commenters criticized the Commission's consideration of whether the rule will promote capital formation.[299] One commenter specifically questioned whether the proposed rule would improve the flow of information with regard to indexed annuities, suggesting that the Commission should delineate where the states' current disclosure regime falls short, and how the rule would improve upon it, as well as how the benefits of

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[298] See, e.g., Section 12(a)(2) of the Securities Act [15 U.S.C. 77l(a)(2)] (imposing liability for materially false or misleading statements in a prospectus or oral communication, subject to a reasonable care defense). See also Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)]; rule 10b-5 under the Exchange Act [17 CFR 240.10b-5]; Section 17 of the Securities Act [15 U.S.C. 77q] (general antifraud provisions).

[299] See, e.g., Coalition Letter, supra note 54; NAFA Letter, supra note 54.

the rule would exceed its costs.[300] We disagree. It is not our intention to question the effectiveness of state regulation. We continue to believe that applying the federal securities disclosure scheme to indexed annuities will enhance disclosure of information needed to make informed investment decisions. The information will enhance investors' abilities to compare various indexed annuities and also compare indexed annuities with mutual funds, variable annuities, and other securities and finanancial products. We believe that state insurance laws, enforced by multiple regulators whose primary charge is the solvency of the issuing insurance company, cannot serve as an adequate substitute for uniform, enforceable investor protections provided by the federal securities laws. At least one state regulator has acknowledged the developmental nature of state efforts and the lack of uniformity in those efforts.[301] Congress has prescribed a uniform federal regulatory scheme for securities having already weighed whether the federal securities laws are well-suited to securities. In addition, the courts have recognized that labeling a product as insurance does not remove it from the federal regulatory scheme.

The federal securities laws will further improve upon the state structure because of the Commission's long history of creating appropriate disclosure requirements for different types of securities, including securities issued by insurance companies, such as variable annuities and variable life insurance,[302] the federal regulatory scheme's

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300 Coalition Letter, supra note 54.

301 See Voss Letter, supra note 13.

302 See e.g., Form N-4 [17 CFR 239.17b and 274.11c] (registration form for variable annuities); Form N-6 [17 CFR 239.17c and 274.11d] (registration form for variable life insurance).

uniformity in application, the suitability requirements enforced by FINRA, as well as the Commission and FINRA's robust enforcement powers and the private remedies allowed under the federal securities laws.

Another commenter stated that the proposed rule would only promote capital formation if it resulted in increased sales of indexed annuities, and that the Commission has not analyzed the rule to the point where it can determine whether or not it will increase indexed annuity sales.[303] We strongly disagree that the correct measure of whether the rule will promote capital formation is if it results in increased sales of indexed annuities. We believe that capital formation would be enhanced through increased competition among indexed annuities and among indexed annuities and other financial products, such as variable annuities and mutual funds, and the innovation and better terms in indexed annuities for investors that may result from this competition. Better information leads to increased competition and greater investor confidence in markets which will in turn lead to willingness to invest and facilitate capital formation. Moreover, it is not possible to predict with certainty whether indexed annuity sales will themselves increase or decrease as a result of the rule. The Commission has taken both possibilities into account. In any event, we believe, first, that the importance of protecting purchasers of these products under the federal securities laws is significant notwithstanding any reduction in capital formation that may result from fewer sales of indexed annuities and second, that any such reduction is likely to be offset by an increase in capital formation through sales of other financial products.

Rule 12h-7 provides insurance companies with an exemption from Exchange Act

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303 NAFA Letter, supra note 54.

reporting with respect to indexed annuities and certain other securities that are regulated as insurance under state law. We are adopting this exemption because the concerns that Exchange Act financial disclosures are intended to address are generally not implicated where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law and where there is no trading interest in an insurance contract. Accordingly, we believe that the exemption will improve efficiency by eliminating potentially duplicative and burdensome regulation relating to insurers' financial condition. Furthermore, we believe that rule 12h-7 will not impose any burden on competition. Rather, we believe that the rule will enhance competition among insurance products and between insurance products and other financial products because the exemption may encourage insurers to innovate and introduce a range of new insurance contracts that are securities, since the exemption will reduce the regulatory costs associated with doing so. We also anticipate that the innovations in product development could promote capital formation by providing new investment opportunities for investors.

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.[304] It relates to the Commission's rule 151A that defines the terms "annuity contract" and "optional annuity contract" under the Securities Act of 1933 and rule 12h-7 that exempts insurance companies from filing reports under the Securities Exchange Act of 1934 with respect to indexed annuities and other securities

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304 5 U.S.C. 604 et seq.

that are registered under the Securities Act, subject to certain conditions, both of which we are adopting in this Release. The Initial Regulatory Flexibility Analysis ("IRFA") which was prepared in accordance with 5 U.S.C. 603 was published in the Proposing Release.

A. Need For and Objectives of Rules

We are adopting the definition of the terms "annuity contract" and "optional annuity contract" to provide greater clarity with regard to the status of indexed annuities under the federal securities laws. We believe this will enhance investor protection and provide greater certainty to the issuers and sellers of these products with respect to their obligations under the federal securities laws. We are adopting the exemption from Exchange Act reporting because we believe that the concerns that periodic financial disclosures are intended to address are generally not implicated where an insurer's financial condition and ability to meet its contractual obligations are subject to oversight under state law and where there is no trading interest in an insurance contract.

B. Significant Issues Raised By Public Comment

In the Proposing Release, we requested comment on the number of small entity insurance companies, small entity distributors of indexed annuities, and any other small entities that may be affected by the rules, the existence or nature of the potential impact and how to quantify the impact of the rules. A number of commenters stated that costs and burdens arising from rule 151A would have a significant and adverse impact on small entities, such as small insurance distributors.[305] Commenters have estimated the number

[305] See, e.g., Letter A, supra note 76; Letter of Dennis Absher (Jul. 25, 2008) ("Absher Letter"); Letter of James Brenner (Jul. 7, 2008) ("Brenner Letter"); Letter E, supra note 76; Letter of Dustin R. Montgomery (Sep. 11, 2008) ("Montgomery Letter"); Letter of

of small entities to be adversely affected by this rule to range from thousands to tens of thousands of small entities.[306] Insurance distributors that would be affected by the rule are not registered with the Commission. For that reason, we do not have information pertaining to the number of such distributors, or the number of small distributors. While commenters provided a range of numbers of small entities, they did not explain the basis for their estimates.

Some commenters stated that the estimate of the burden on small entities in the proposing release is understated.[307] In particular, one commenter stated that small entities among distributors who network with registered broker-dealers will incur not only legal and monitoring costs, as the Proposing Release recognized, but will also have to share commissions that they earn from the sales of indexed annuities.[308] While we did not specifically address sharing of commissions in the Proposing Release, we recognize that networking may cause small distributors to share commissions with registered broker-dealers. However, we continue to believe that networking may be more cost-effective than registering as a broker-dealer. We recognize that a distributor will incur costs in entering into networking arrangement. However, these costs are not unique to indexed annuities. For example, issuers of insurance products registered as securities,

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Raymond J. Ohlson, The Ohlson Group, Inc. (Jul. 22, 2008) ("Ohlson Letter"); Letter of Steven A Sewell (Aug. 25, 2008) ("Sewell Letter"); Letter of Donna Tupper (Sept. 11, 2009) ("Tupper Letter").

306 See, e.g., Letter of Matthew Coleman (Jul. 11, 2008) ("Coleman Letter"); Letter of Bruce E. Dickes (Jul. 16, 2008) ("Dickes Letter"); Letter Type K ("Letter K"); Letter of Larry A. Kaufman (Aug. 27, 2008) ("Kaufman Letter"); Letter of Dejah F. LaMonte (Sep. 3, 2008) ("LaMonte Letter"); Letter of Kyle Mann (Sep. 9, 2008) ("Mann Letter").

307 See, e.g., Coalition Letter, supra note 54.

308 Coalition Letter, supra note 54

such as variable annuities, may incur networking costs, as do banks involved in networking arrangements. Moreover, while we would expect networking to be generally more cost-effective than registration as a broker-dealer, to the extent that it is not more efficient, broker-dealer registration remains an option for indexed annuity distributors. We believe that the upper bound of the cost of entering into a networking agreement is the equivalent of the costs of establishing a registered broker-dealer. Commenters provided a range of cost estimates for establishing a registered broker-dealer, ranging from $250,000 to $3 million.

As discussed below, it is the view of the Commission that, despite any adverse impact to small entities that may result, rule 151A is a necessary measure for the protection of purchasers of indexed annuities. Rule 151A will result in significant benefits to indexed annuity purchasers, including federally mandated disclosure and sales practice protections. Moreover, rule 151A offers benefits to all entities, large and small, such as greater regulatory certainty with regard to the status of indexed annuities under the federal securities laws and enhance competition. We do not anticipate that rule 151A will impose different or additional burdens on small entities than those imposed on other small entities who issue or distribute securities. Commenters generally supported rule 12h-7 and did not raise any issues regarding the effect of rule 12h-7 on small entities.

C. Small Entities Subject to the Rules

The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission.[309] Rule 0-10(a)[310] defines an issuer, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year.[311] No insurers currently issuing indexed annuities are small entities.[312] In addition, no other insurers that would be covered by the Exchange Act exemption are small entities.[313]

While there are no small entities among the insurers who are subject to the new

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309 See rule 157 under the Securities Act [17 CFR 230.157]; rule 0-10 under the Exchange Act [17 CFR 240.0-10].

310 17 CFR 240.0-10(a).

311 Securities Act rule 157(a) [17 CFR 157(a)] generally defines an issuer, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year and it is conducting or proposing to conduct a securities offering of $5 million or less. For purposes of our analysis, however, we use the Exchange Act definition of "small business" or "small entity" because that definition includes more issuers than does the Securities Act definition and, as a result, assures that the definition we use would not itself lead to an understatement of the impact of the amendments on small entities.

312 The staff has determined that each insurance company that currently offers indexed annuities has total assets significantly in excess of $5 million. The staff compiled a list of indexed annuity issuers from four sources: AnnuitySpecs, Carrier List, http://www.annuityspecs.com/Page.aspx?s=carrierlist; Annuity Advantage, Equity Indexed Annuity Data, http://www.annuityadvantage.com/annuitydataequity.htm; Advantage Compendium, Current Rates, http://www.indexannuity.org/rates_by_carrier.htm; and a search of BEST'S COMPANY REPORTS (available on LEXIS) for indexed annuity issuers. The total assets of each insurance company issuer of indexed annuities were determined by reviewing the most recent BEST'S COMPANY REPORTS for each indexed annuity issuer.

313 The staff has determined that each insurance company that currently offers contracts that are registered under the Securities Act and that include so-called market value adjustment features or guaranteed benefits in connection with assets held in an investor's account has total assets significantly in excess of $5 million. The total assets of each such insurance company were determined by reviewing the Form 10-K of that company and, in some cases, BEST'S COMPANY REPORTS (available on LEXIS).

rules 151A and 12h-7, we note that there may be a substantial number of small entities among distributors of indexed annuities.[314] Rule 0-10(c)[315] states that the term "small business" or "small organization," when referring to a broker-dealer that is not required to file audited financial statements prepared pursuant to rule 17a-5(d) under the Exchange Act,[316] means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. Rule 0-10(a)[317] states that the term "small business" or "small organization," when used with reference to a "person," other than an investment company, means a "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less.

D. Reporting, Recordkeeping, and Other Compliance Requirements

Rule 151A will result in Securities Act filing obligations for those insurance companies that, in the future, issue indexed annuities that fall outside the insurance exemption under rule 151A, and rule 12h-7 will result in the elimination of Exchange Act reporting obligations for those insurance companies that meet the conditions to the exemption. As noted above, no insurance companies that currently issue indexed annuities or that would be covered by the exemption are small entities.

However, rule 151A may affect indexed annuity distributors that are small entities

314 See supra note 306 and accompanying text.

315 17 CFR 240.0-10(c).

316 17 CFR 240.17a-5(d).

317 17 CFR 240.0-10(a).

and that are not currently parties to a networking arrangement or registered as broker-dealers. While these entities may choose to register as broker-dealers, in order to continue to distribute indexed annuities that are registered as securities, these distributors would likely enter into a networking arrangement with a registered broker-dealer. Under these arrangements, an affiliated or third-party broker-dealer provides brokerage services for an insurance agency's customers, in connection with transactions in insurance products that are also securities. Entering into a networking arrangement would impose costs associated with contracting with the registered broker-dealer regarding the terms, conditions, and obligations of each party to the arrangement. We anticipate that a distributor will incur legal costs in connection with entering into a networking arrangement with a registered broker-dealer, as well as ongoing costs associated with monitoring compliance with the terms of the networking arrangement.[318] Entities that enter into such networking arrangements would not be subject to ongoing reporting, recordkeeping, or other compliance requirements imposed by the federal securities laws. If any of these entities were to choose to register as broker-dealers as a result of rule 151A,[319] they would be subject to ongoing reporting, recordkeeping, and other compliance requirements applicable to registered broker-dealers. Compliance with these requirements, if applicable, would impose costs associated with accounting, legal, and other professional personnel, and the design and operation of automated and other

[318] See discussion supra Part V.B. The costs borne by distributors entering into networking arrangements will be borne by both large and small distributors of registered indexed annuities.

[319] See, e.g., Submission for OMB Review; Comment Request, OMB Control No. 3235-0012 [72 FR 39646 (Jul. 19, 2007)] (discussing the total annual burden imposed by Form BD).

compliance systems.[320]

E. Commission Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the adoption of rule 151A and rule 12h-7, we considered the following alternatives:

- establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- further clarifying, consolidating, or simplifying the requirements for small entities;
- using performance standards rather than design standards; and
- providing an exemption from the requirements, or any part of them, for small entities.

Because no insurers that currently issue indexed annuities or that will be covered by the Exchange Act exemption are small entities, consideration of these alternatives for those insurance companies is not applicable. Small distributors of indexed annuities that choose to enter into networking arrangements with registered broker-dealers, which we believe will be likely once rule 151A is adopted, would not be subject to ongoing reporting, recordkeeping, or other compliance requirements. However, because some small distributors may choose to register as broker-dealers, we did consider the alternatives above for small distributors.

Commenters did not suggest any alternatives specifically addressed to small

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320 See supra notes 265-268 and accompanying text.

entities. Some commenters suggested that the Commission, instead of adopting a rule that defines certain indexed annuities as not being "annuity contracts" under Section 3(a)(8), should instead define a safe harbor that would provide that indexed annuities that meet certain conditions are entitled to the Section 3(a)(8) exemption.[321] We are not adopting this approach for two reasons. First, such a rule would not address in any way the federal interest in providing investors with disclosure, antifraud, and sales practice protections that arise when individuals are offered indexed annuities that expose them to investment risk. A safe harbor would address circumstances where purchasers of indexed annuities are **not** entitled to the protections of the federal securities laws; one of our primary goals is to address circumstances where purchasers of indexed annuities **are** entitled to the protections of the federal securities laws. We are concerned that many purchasers of indexed annuities today should be receiving the protections of the federal securities laws, but are not. Rule 151A addresses this problem; a safe harbor rule would not. Second, we believe that, under many of the indexed annuities that are sold today, the purchaser bears significant investment risk and is more likely than not to receive a fluctuating, securities-linked return. In light of that fact, we believe that is far more important to address this class of contracts with our definitional rule than to address the remaining contracts, or some subset of those contracts, with a safe harbor rule.

The Commission believes that different registration, compliance, or reporting requirements or timetables for small entities that distribute registered indexed annuities

[321] See, e.g., Academy Letter, supra note 54; AIG Letter, supra note 128; Aviva Letter, supra note 54; Second Academy Letter, supra note 54; Second Aviva Letter, supra note 54; Second Transamerica Letter, supra note 54; Letter of Life Insurance Company of the Southwest (Sept. 10, 2008) ("Southwest Letter"); Voss Letter, supra note 13.

would not be appropriate or consistent with investor protection. The rules will provide investors with the sales practice protections of the federal securities laws when they purchase indexed annuities that are outside the insurance exemption. These indexed annuities would be required to be distributed by a registered broker-dealer. As a result, investors who purchase these indexed annuities after the effective date of rule 151A would receive the benefits associated with a registered representative's obligation to make only recommendations that are suitable.. The registered representatives who sell registered indexed annuities would be subject to supervision by the broker-dealer with which they are associated, and the selling broker-dealers would be subject to the oversight of FINRA. The registered broker-dealers would also be required to comply with specific books and records, supervisory, and other compliance requirements under the federal securities laws, as well as to be subject to the Commission's general inspections and, where warranted, enforcement powers.

Different registration, compliance, or reporting requirements or timetables for small entities that distribute indexed annuities may create the risk that investors will receive lesser sales practice and other protections when they purchase a registered indexed annuity through a distributor that is a small entity. We believe that it is important for all investors that purchase indexed annuities that are outside the insurance exemption to receive equivalent protections under the federal securities laws, without regard to the size of the distributor through which they purchase. For those same reasons, the Commission also does not believe that it would be appropriate or consistent with investor protection to exempt small entities from the broker-dealer registration requirements when those entities distribute indexed annuities that fall outside of the insurance exemption under our rules.

Through our existing requirements for broker-dealers, we have endeavored to minimize the regulatory burden on all broker-dealers, including small entities, while meeting our regulatory objectives. Small entities that distribute indexed annuities that are outside the insurance exemption under our rule should benefit from the Commission's reasoned approach to broker-dealer regulation to the same degree as other entities that distribute securities. In our existing broker-dealer regulatory framework, we have endeavored to clarify, consolidate, and simplify the requirements applicable to all registered broker-dealers, and the rules do not change those requirements in any way. Finally, we do not consider using performance rather than design standards to be consistent with investor protection in the context of broker-dealer registration, compliance, and reporting requirements.

VIII. STATUTORY AUTHORITY

The Commission is adopting the amendments outlined above under Sections 3(a)(8) and 19(a) of the Securities Act [15 U.S.C. 77c(a)(8) and 77s(a)] and Sections 12(h), 13, 15, 23(a), and 36 of the Exchange Act [15 U.S.C. 78l(h), 78m, 78o, 78w(a), and 78mm].

List of Subjects

17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

TEXT OF RULES

For the reasons set forth in the preamble, the Commission amends Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 230 – GENERAL RULES AND REGULATONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll (d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Add § 230.151A to read as follows:

§ 230.151A Certain contracts not "annuity contracts" or "optional annuity contracts" under section 3(a)(8).

(a) General. Except as provided in paragraph (c) of this section, a contract that is issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia, and that is subject to regulation under the insurance laws of that jurisdiction as an annuity is not an "annuity contract" or "optional annuity contract" under Section 3(a)(8) of the Securities Act (15 U.S.C. 77c(a)(8)) if:

(1) The contract specifies that amounts payable by the issuer under the contract are calculated at or after the end of one or more specified crediting periods, in whole or in part, by reference to the performance during the crediting period or periods of a security, including a group or index of securities; and

(2) Amounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract.

(b) Determination of amounts payable and guaranteed. In making the determination under paragraph (a)(2) of this section:

(1) Amounts payable by the issuer under the contract and amounts guaranteed under the contract shall be determined by taking into account all charges under the contract, including, without limitation, charges that are imposed at the time that payments are made by the issuer; and

(2) A determination by the issuer at or prior to issuance of the contract shall be conclusive, provided that:

(i) Both the methodology and the economic, actuarial, and other assumptions used in the determination are reasonable;

(ii) The computations made by the issuer in support of the determination are materially accurate; and

(iii) The determination is made not more than six months prior to the date on which the form of contract is first offered.

(c) Separate accounts. This section does not apply to any contract whose value varies according to the investment experience of a separate account.

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

3. 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.

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4. Add § 240.12h-7 to read as follows:

§ 240.12h-7 Exemption for issuers of securities that are subject to insurance regulation.

An issuer shall be exempt from the duty under section 15(d) of the Act (15 U.S.C. 78o(d)) to file reports required by section 13(a) of the Act (15 U.S.C. 78m(a)) with respect to securities registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.), provided that:

(a) The issuer is a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State;

(b) The securities do not constitute an equity interest in the issuer and are either subject to regulation under the insurance laws of the domiciliary State of the issuer or are guarantees of securities that are subject to regulation under the insurance laws of that jurisdiction;

(c) The issuer files an annual statement of its financial condition with, and is supervised and its financial condition examined periodically by, the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of the issuer's domiciliary State;

(d) The securities are not listed, traded, or quoted on an exchange, alternative trading system (as defined in §242.300(a) of this chapter), inter-dealer quotation system (as defined in § 240.15c2-11(e)(2)), electronic communications network, or any other similar system, network, or publication for trading or quoting;

(e) The issuer takes steps reasonably designed to ensure that a trading market for the securities does not develop, including, except to the extent prohibited by the law of any State or by action of the insurance commissioner, bank commissioner, or any agency or officer performing like functions of any State, requiring written notice to, and acceptance by, the issuer prior to any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis; and

(f) The prospectus for the securities contains a statement indicating that the issuer is relying on the exemption provided by this rule.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

January 8, 2009

Opening Remarks and Dissent
by
Commissioner Troy A. Paredes

Regarding Final Rule 151A: Indexed Annuities and Certain Other Insurance Contracts

Open Meeting of the Securities & Exchange Commission

December 17, 2008

Thank you, Chairman Cox.

I believe that proposed Rule 151A addressing indexed annuities is rooted in good intentions. For instance, at the time the rule was proposed, the Commission watched a television clip from *Dateline NBC* that described individuals who may have been misled by seemingly unscrupulous sales practices into buying these products. Part of our tripartite mission at the SEC is to protect investors, so there is a natural tendency to want to act when we hear stories like this.

However, our jurisdiction is limited; and thus our authority to act is circumscribed. Rule 151A is about this very question: the proper scope of our statutory authority.

In our effort to protect investors, we cannot extend our reach past the statutory stopping point. Section 3(a)(8) of the Securities Act of 1933 ('33 Act) provides a list of securities that are exempt from the '33 Act and thus, by design of the statute, fall beyond the Commission's reach. The Section 3(a)(8) exemption includes, in relevant part, "[a]ny insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner . . . of any State or Territory of the United States or the District of Columbia." I am not persuaded that Rule 151A represents merely an attempt to provide clarification to the scope of exempted securities falling within Section 3(a)(8). Instead, by defining indexed annuities in the manner done in Rule 151A, I believe the SEC will be entering into a realm that Congress prohibited us from entering. Therefore, I cannot vote in favor of the rule and respectfully dissent.

Rule 151A takes some annuity products (indexed annuities), which otherwise may be covered by the statutory exemption in Section 3(a)(8), and removes them from the exemption, thus placing them within the Commission's jurisdiction to regulate. If the Commission's Rule 151A analysis is wrong – which is to say that indexed annuities *do* fall within Section 3(a)(8) – then the SEC has exceeded its authority by seeking to regulate them. In other words, the effect of Rule 151A would be to confer additional authority upon the SEC when these products, in fact, are entitled to the Section 3(a)(8) exemption.

The Supreme Court has twice construed the scope of Section 3(a)(8) for annuity contracts in the *VALIC* and *United Benefit* cases.[1] I believe the approach embraced by Rule 151A conflicts with these Supreme Court cases. Although neither *VALIC* nor

[1] *See generally SEC v. Variable Annuity Life Ins. Co. of Am.*, 359 U.S. 65 (1959); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967).

United Benefit deals with indexed annuities directly, the cases nevertheless are instructive in evaluating whether such a product falls within the Section 3(a)(8) exemption. And despite the adopting release's efforts to discount its holding, at least one federal court applying *VALIC* and *United Benefit* has held that an indexed annuity falls within the statutory exemption of Section 3(a)(8).[2]

When fixing the contours of Section 3(a)(8), the relevant features of the product at hand should be considered to determine whether the product falls outside the Section 3(a)(8) exemption. Rule 151A places singular focus on investment risk without adequately considering another key factor – namely, the manner in which an indexed annuity is marketed.

Moreover, I believe that Rule 151A misconceptualizes investment risk for purposes of Section 3(a)(8). The extent to which the purchaser of an indexed annuity bears investment risk is a key determinant of whether such a product is subject to the Commission's jurisdiction. Rule 151A denies an indexed annuity the Section 3(a)(8) exemption when it is "more likely than not" that, because of the performance of the linked securities index, amounts payable to the purchaser of the annuity contract will exceed the amounts the insurer guarantees the purchaser. This approach to investment risk gives short shrift to the guarantees that are a hallmark of indexed annuities. In other words, the central insurance component of the product eludes the Rule 151A test. More to the point, Rule 151A in effect treats the possibility of upside, beyond the guarantee of principal and the guaranteed minimum rate of return the purchaser enjoys, as investment

[2] *See Malone v. Addison Ins. Mktg., Inc.*, 225 F. Supp. 2d 743 (W.D. Ky. 2002).

risk under Section 3(a)(8). I believe that it is more appropriate to emphasize the extent of downside risk – that is, the extent to which an investor is subject to a risk of loss – in determining the scope of Section 3(a)(8). When investment risk is properly conceived of in terms of the risk of loss, it becomes apparent why indexed annuities may fall within Section 3(a)(8) and thus beyond this agency's reach, contrary to Rule 151A.

Not only does Rule 151A seem to deviate from the approach taken by courts, including the Supreme Court, but it also appears to depart from prior positions taken by the Commission. For example, in an amicus brief filed with the Supreme Court in the *Otto* case,[3] the Commission asserted that the Section 3(a)(8) exemption applies when an insurance company, regulated by the state, assumes a "sufficient" share of investment risk and there is a corresponding decrease in the risk to the purchaser, such as where the purchaser benefits from certain guarantees. Yet Rule 151A denies the Section 3(a)(8) exemption to an indexed annuity issued by a state-regulated insurance company that bears substantial risk under the annuity contract by guaranteeing principal and a minimum return.

In addition, Rule 151A seems to diverge from the analysis embedded in Rule 151. Rule 151 establishes a true safe harbor under Section 3(a)(8) and provides that a variety of factors should be considered, such as marketing techniques and the availability of guarantees. The Rule 151 adopting release even indicates that the rule allows for certain "indexed excess interest features" without the product falling outside the safe harbor.

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[3] *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127 (7th Cir. 1987). The Supreme Court denied the petition for a writ of certiorari.

An even more critical difference between Rule 151 and Rule 151A is the effect of failing to meet the requirements under the rule. If a product does not meet the requirements of Rule 151, there is no safe harbor, but the product nevertheless may fall within Section 3(a)(8) and thus be an exempted security. But if a product does not pass muster under the Rule 151A "more likely than not" test, then the product is deemed to fall outside Section 3(a)(8) and thus is under the SEC's jurisdiction. In essence, while Rule 151 provides a safe harbor, Rule 151A takes away the Section 3(a)(8) statutory exemption.

I am not aware of another instance in the federal securities laws where a "more likely than not" test is employed, and for good reason. A "more likely than not" test does not provide insurers with proper notice of whether their products fall within the federal securities laws or not. If an insurer applies the test in good faith and gets it wrong, the insurer nonetheless risks being subject to liability under Section 5 of the Securities Act, even if the insurer had no intent to run afoul of the federal securities laws. In addition, under the "more likely than not" test, the availability of the Section 3(a)(8) exemption turns on the insurer's own analysis. Accordingly, it is at least conceivable that the same product could receive different Section 3(a)(8) treatment depending on how each respective insurer modeled the likely returns.

Further, I am concerned that Rule 151A, as applied, reveals that the "more likely than not" test, despite its purported balance, leads to only one result: the denial of the

Section 3(a)(8) exemption. In practice, Rule 151A appears to result in blanket SEC regulation of the entire indexed annuity market. The adopting release indicates that over 300 indexed annuity contracts were offered in 2007 and explains that the Office of Economic Analysis has determined that indexed annuity contracts with typical features would not meet the Rule 151A test. Indeed, the adopting release elsewhere expresses the expectation that almost all indexed annuity contracts will fail the test. If everyone is destined to fail, what is the purpose of a test? Further, there is at least some risk that in sweeping up the index annuity market, the rule may sweep up other insurance products that otherwise should fall within Section 3(a)(8).

The rule has other shortcomings, aside from the legal analysis that underpins it. These include, but are not limited to, the following.

First, a range of state insurance laws govern indexed annuities. I am disappointed that the rule and adopting release make an implicit judgment that state insurance regulators are inadequate to regulate these products. Such a judgment is beyond our mandate or our expertise. In any event, Section 3(a)(8) does not call upon the Commission to determine whether state insurance regulators are up to the task; rather, the section exempts annuity contracts subject to state insurance regulation.

Second, as a result of Rule 151A, insurers will have to bear various costs and burdens, which, importantly, could disproportionately impact small businesses. Some even have predicted that companies may be forced out of business if Rule 151A is adopted. Such an outcome causes me concern, especially during these difficult economic times. Even when the economy is not strained, such an outcome is disconcerting because it can lead to less competition, ultimately to the detriment of consumers.

Third, the Commission received several thousand comment letters since Rule 151A was proposed in June 2008. Consistent with comments we have received, I believe that there are more effective and appropriate ways to address the concerns underlying this rulemaking. One possible alternative to Rule 151A would be amending Rule 151 to establish a more precise safe harbor in light of all the relevant facts and circumstances attendant to indexed annuities and how they are marketed. A more precise safe harbor would provide better clarity and certainty in this area – regulatory goals the Commission has identified – and would preserve the ability of insurers to find an exemption outside the safe harbor by relying directly on Section 3(a)(8) and the cases interpreting it. I believe further exploration of alternative approaches is warranted, as is continued engagement with interested parties, including state regulators.

In closing, I request that my remarks be included in the Federal Register with the final version of the release. My remarks today do not give a full exposition of the rule's shortcomings, but rather highlight some of the key points that lead me to dissent. I wish to note that these dissenting remarks just given represent my view after giving careful consideration to the range of arguments presented by the Commission's staff, particularly the Office of General Counsel, the commenters, and my own counsel, as well as those of my fellow Commissioners. Although I cannot support the rule, I nonetheless thank the staff for the hard work they have devoted to its preparation.

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 **January 2009**, 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.
Elisse B. Walter was Acting Chairman from January 21- 27, 2009 at 9:31 a.m.

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

ELISSE B. WALTER, ACTING CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

3 Documents

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59287; File No. SR-ISE-2006-26)

January 23, 2009

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of the Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to Professional Account Holders

I. Introduction

On May 5, 2006, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder[2] to amend ISE rules to give certain non-broker-dealer orders, identified as "professional orders," the priority given broker-dealer orders and market maker quotes rather than the priority currently given all public customer orders and to charge the same transaction fees for professional orders as charged for the orders of broker-dealers and market makers. On January 25, 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 comment in the Federal Register on February 7, 2008.[3] The Commission received ten comment letters on the proposal.[4] The Exchange filed

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 57254 (February 1, 2008), 73 FR 7345 (February 7, 2008) ("Notice").

4 See letters from Abe Lampert, dated May 25, 2006 ("Lampert Letter"); Charles B. Cox III, dated May 26, 2006 ("Cox Letter I"); B. Thomas Rule, dated May 28, 2006 ("Rule Letter"); Bryan Weisberg, dated May 31, 2006 ("Weisberg Letter"); Andrea Schneider, dated June 18, 2006 ("A. Schneider Letter"); Gerald Schneider, dated February 6, 2008 ("G. Schneider Letter"); Andrew Carr, dated March 4, 2008 ("Carr Letter"); Charles B. Cox III, dated March 4, 2008 ("Cox Letter II"); Charles B. Cox III, dated April 16, 2008 ("Cox Letter III"); and Securities Industry and Financial Markets Association ("SIFMA"), dated July 23, 2008 ("SIFMA Letter").

Amendment No. 2 to the proposed rule change on June 17, 2008,[5] and submitted a response to the SIFMA Letter on January 12, 2009.[6] This order provides notice of Amendment No. 2 and approves the proposal, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

II. Description of ISE's Proposal

Currently, ISE grants certain advantages to Public Customer Orders[7] over Non-Customer Orders.[8] In particular, Public Customer Orders receive priority over Non-Customer Orders and market maker quotes at the same price. In addition, subject to certain exceptions, Public Customer Orders do not incur transaction charges.[9] The ISE states that the purpose, generally, of providing these marketplace advantages to Public Customer Orders is to attract retail investor order flow to the Exchange by leveling the playing field for retail investors over market professionals and providing competitive pricing.[10] According to the Exchange, market professionals have access to sophisticated trading systems that contain functionality not available

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5 In Amendment No. 2, ISE deleted proposed changes to ISE Rules 715 and 723 (d)(2). These revisions clarify that the proposed rule change would not limit a Public Customer's access to the Exchange's Price Improvement Mechanism ("PIM"). See infra note 75.

6 See letter from Michael J. Simon, Secretary, ISE, to Florence Harmon, Acting Secretary, Commission, dated January 12, 2009 ("ISE Response Letter").

7 A "Public Customer" is defined in ISE's rules as "a person that is not a broker or dealer in securities." A "Public Customer Order" is defined as "an order for the account of a Public Customer." ISE Rules 100(a)(38) and (39).

8 A "Non-Customer" is defined in ISE's rules as "a person or entity that is a broker or dealer in securities." A "Non-Customer Order" is defined as "any order that is not a Public Customer Order." ISE Rules 100(a)(27) and (28).

9 For example, Public Customer Orders currently incur fees for certain transactions in "Premium Products" (defined in the ISE Schedule of Fees) and Complex Orders that take liquidity on the Exchange's complex order book. In addition, transaction fees are charged for Public Customer Orders entered in response to special order broadcasts, such as Facilitation orders, Solicitation orders, Block orders, and orders entered in the Exchange's PIM. Public Customer Orders also are subject to fees for order cancellations. See ISE Schedule of Fees.

10 See Notice, supra note 3, at 73 FR 7346.

to a retail customer, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously, and order and risk management tools.[11]

With respect to the marketplace advantages of priority in trading and waiver of fees, the Exchange does not believe at this time that the definitions of Public Customer and Non-Customer properly distinguish between the kind of non-professional retail investors for whom these advantages were intended and certain professionals. The Exchange believes that distinguishing solely between registered broker-dealers and non-broker-dealers with respect to these advantages is no longer appropriate in today's marketplace, because some non-broker-dealer individuals and entities have access to information and technology that enables them to trade listed options in the same manner as a broker or dealer in securities. The Exchange maintains that these individual traders and entities (collectively, "professional account holders") have the same technological and informational advantages as broker-dealers trading for their own accounts, which enables professional account holders to compete effectively with broker-dealer orders and market maker quotes for execution opportunities in the ISE marketplace.[12] The Exchange therefore does not believe that it is consistent with fair competition for these professional accounts holders to continue to receive the same marketplace advantages that retail investors have over broker-dealers trading on the ISE.[13]

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11 See Notice, supra note 3, at 73 FR 7346 n.7.

12 The Exchange also maintains that, under its current rules, retail investors are prevented from fully benefiting from the priority advantage when professional account holders are afforded the same Public Customer Order priority that retail investors enjoy. See Notice, supra note 3, at 73 FR 7346.

13 Id.

ISE thus proposes to create two new order types: Priority Customer Orders and Professional Orders. Priority Customer Orders would be orders for the account of a Priority Customer, which would be defined as a person or entity that is not a broker-dealer in securities and that does not place more than 390 orders[14] in listed options per day on average during a calendar month for its own beneficial account(s). Professional Orders would be defined as orders for the account of a person or entity that is not a Priority Customer, and would include proprietary orders of ISE members and non-member broker-dealers.[15] Priority Customer Orders would have priority over Professional Orders at the same price. Thus, Public Customers who now have priority over market makers and broker-dealers at the same price would be on parity with market markers and broker-dealers at the same price, if those Public Customers placed more than 390 orders in listed options per day on average during a calendar month. These Professional Orders also would be assessed the same fees that ISE charges for broker-dealer transactions.

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14 The Exchange states that 390 orders is equal to the total number of orders that a person would place in a day if that person entered one order every minute from market open to market close. According to ISE, a study of one of the largest retail-oriented options brokerage firms indicated that on a typical trading day, options orders were entered with respect to each of 5,922 different customer accounts. There was only one order entered with respect to 3,765 of the 5,922 different customer accounts on this day, and there were only 17 customer accounts with respect to which more than 10 orders were entered. The highest number of orders entered with respect to any one account over the course of an entire week was 27. In addition, many of the largest retail-oriented electronic brokers offer lower commission rates to customers they define as "active traders." The Exchange reviewed the publicly available information from the web sites for Charles Schwab & Co., Inc.; Fidelity Investments; TD Ameritrade, Inc.; and optionsXpress, Inc., and found all of them define an "active trader" as someone who executes only a relatively small number of options trades per month. The highest required trading activity to qualify as an active trader among these four firms was 35 trades per quarter. See Notice, supra note 3, at 73 FR 7347 n.10-11.

15 Members would be required to represent as Professional Orders for the next calendar quarter the orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter. See proposed Text of Regulatory Circular filed by ISE as part of the proposed rule change ("Proposed Regulatory Circular").

The Exchange believes that the use of these new terms in the execution rules and fee schedule would result in professional account holders participating in the ISE's allocation process on equal terms with broker-dealer orders and market maker quotes. It would also result in members paying the same transaction fees for the execution of orders for a professional account as they do for broker-dealer orders. The Exchange believes that identifying professional account holders as participants who place more than one order per minute on average per day during a calendar month is an appropriately objective approach that would reasonably distinguish such persons and entities from retail investors. The Exchange proposes the threshold of 390 orders per day on average over a calendar month because it believes this amount far exceeds the number of orders that are entered by retail investors in a single day, while being a sufficiently low number of orders to cover the professional account holders that are competing with broker-dealers in the ISE marketplace. ISE further notes that basing the standard on the number of orders that are entered in listed options for a beneficial account(s) assures that professional account holders could not inappropriately avoid the purpose of the rule by spreading their trading activity over multiple exchanges, and using an average number over a calendar month would prevent gaming of the 390 order threshold.[16]

ISE's proposal would require Electronic Access Members ("EAMs") to indicate whether Public Customer Orders are Priority Customer Orders or Professional Orders. EAMs would be required to review their customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should be represented as Priority Customer Orders or Professional Orders. Members would be required to make any appropriate changes to the way in which they are representing orders within five days after the end of each

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16 See Notice, supra note 3, at 73 FR 7346-47.

calendar quarter. If during a calendar quarter the Exchange identified a customer for which orders are being represented as Priority Customer Orders, but that customer has averaged more than 390 orders per day during a month, the Exchange would notify the member and the member would be required to change the manner in which it is representing the customer's orders within five days.[17]

All Public Customers would continue to be treated in the same manner under all ISE rules, other than those rules for priority and transaction fees. For example, ISE rules relating to the Intermarket Linkage affecting Public Customers[18] would continue to apply to all customers who are not broker-dealers – even those customers whose orders are identified as Professional Orders. Similarly, rules regarding customer suitability and other protections for customers would continue to apply with respect to all customers who are not broker-dealers.[19]

III. Commission Findings and Order Granting Accelerated Approval to the Proposed Rule Change as Modified by Amendment Nos. 1 and 2

After careful consideration of the proposed rule change, as well as the comment letters and the ISE Response Letter, the Commission finds that the proposed rule change is consistent with the Act. As the options markets have become more electronic and more competitive over the last several years, the Commission believes that the distinction between a professional who is registered as a broker-dealer and a public customer who is not so registered, but who may trade to the same extent as a broker-dealer, has become blurred.[20] Moreover, the category of public

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17 See Proposed Regulatory Circular, supra note 15.

18 See Chapter 19 of the ISE Rules.

19 See Chapter 6 of the ISE Rules. Telephone conversation between Nancy Burke-Sanow, Assistant Director, Division of Trading and Markets ("Division"), Commission, et al., and Katherine Simmons, Deputy General Counsel, ISE, on March 3, 2008.

20 See, e.g., Nina Mehta, Options Maker-Taker Markets Gain Steam, TRADERSmagazine.com, October 2007, http://www.tradersmagazine.com/issues/20071004/2933-1.html.

customer today includes sophisticated algorithmic traders including former market makers and hedge funds that trade with a frequency resembling that of broker-dealers.[21] The Commission believes that the Act does not require the ISE to treat those customers who meet the high level of trading activity established in the proposal identically to customers who do not meet that threshold.[22]

Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)[23] of the Act and the rules thereunder,[24] and in particular with:

Section 6(b)(4) of the Act, which requires exchanges to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities;[25]

Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange, among other things, be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers;[26] and

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21 Id.

22 The Commission notes that one of the commenters, discussing the proposed rule change before the Exchange filed Amendment No. 1, stated that she placed an average of 170 orders per day. See A. Schneider Letter supra note 4. Under the proposed rule change, as amended, a Public Customer that places this number of orders would be substantially short of the proposed threshold of more than 390 orders per day and thus would not be affected by the rule.

23 15 U.S.C. 78f(b).

24 In approving the proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f). See also infra notes 50-71 and accompanying text.

25 15 U.S.C. 78f(b)(4).

26 15 U.S.C. 78f(b)(5).

Section 6(b)(8) of the Act, which requires the rules of an exchange not to impose any burden on competition not necessary or appropriate in furtherance of the Act.[27]

In addition, the Commission finds that the proposed rule change is consistent with Section 11(a) of the Act.[28]

A. Customer Priority on the Options Exchanges

Currently, the ISE accords priority to all Public Customer Orders at the best bid or offer on the basis of price-time priority before allocating any remaining contracts among Non-Customer Orders and market maker quotes at the same best price. ISE now proposes that only Priority Customer Orders, as defined above, would receive such priority.

In considering this aspect of the proposal, the Commission examined the basis upon which exchanges have granted priority to public customers in the past. The Commission further considered the threshold question of when and whether the orders of public customers must be entitled to priority over the orders of broker-dealers.

In certain contexts, the Commission has characterized an exchange's practice of according priority to public customers' orders as a matter of "tradition."[29] Alternatively, the

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27 15 U.S.C. 78f(b)(8).

28 15 U.S.C. 78k(a). See infra Section III.A.1.

29 See, e.g., Securities Exchange Act Release Nos. 21695 (January 28, 1985), 50 FR 4823 (February 1, 1985) (in considering Chicago Board Options Exchange's ("CBOE") proposal to implement a retail automatic execution system ("RAES") pilot program, the Commission referred to "the traditional priority accorded to public customer orders"); and 22610 (November 8, 1985), 50 FR 47480 (November 18, 1985) (in considering a proposal by the American Stock Exchange ("Amex") to implement an automatic execution feature of its AUTOAMOS system on a pilot basis, the Commission stated that the pilot "ensures the traditional priority accorded public customer orders"). In each of these instances, the Commission was referring specifically to public customer orders that are placed on the book. Such placements may affect the application of priority principles. See, e.g., infra Section III.A.3.

Commission has referred to public customer priority as "the generally accepted auction trading principle of priority of public limit orders over member proprietary orders at the same price."[30]

These references in Commission releases support the Commission's view that the customer priority rule under discussion was not a matter of public customer entitlement derived from the Act, but rather a matter of convention to accommodate public customer orders, or an auction principle applied as a matter of longstanding practice by exchanges. In addition, public customer orders are a source of liquidity in the market, and exchanges have sought to attract such orders by providing public customers certain guarantees that their orders would be executed even in the face of competition from broker-dealers.

The Commission previously has approved exchange rules that apply this "traditional priority" as consistent with the Act but, as discussed below, has approved exchange rules that do not accord priority to public customer orders.[31] In analyzing the concept of public customer priority, the Commission has considered whether public customer priority, or the absence of such priority, is consistent with Section 11(a) of the Act, the agency obligations of the specialist, the protection of investors and the public interest, and the Act, in general.

1. Section 11(a) of the Act

Section 11(a) of the Act prohibits any member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion unless an exception

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30 See, e.g., Securities Exchange Act Release No. 22817 (January 21, 1986), 51 FR 3547 (January 28, 1986) (notice of CBOE's proposal to implement RAES on a permanent basis for options on the Standard and Poor's 100 Index ("OEX") (SR-CBOE-85-32) and to extend RAES to selected classes of individual stock options on a six-month pilot basis (SR-CBOE-85-16) ("January 1986 Release"). See also infra note 40.

31 See infra notes 41-44 and accompanying text.

applies.[32] Thus, in some contexts, the Commission has cited Section 11(a) of the Act as a basis for exchange rules that accord customer orders priority, referring to "the traditional auction market concepts of customer priority embodied in Section 11(a) of the Act."[33]

Section 11(a)(1) contains a number of exceptions for principal transactions by members and their associated persons. One such exception, set forth in subparagraph (G) of Section 11(a)(1) and in Rule 11a1-1(T), permits any transaction for a member's own account provided, among other things, that the transaction yields priority, parity, and precedence to orders for the account of persons who are not members or associated with members of the exchange. Exchange rules, therefore, may require members to yield priority to the orders of public customers to satisfy this exception to Section 11(a). Another exception permits market makers to effect transactions on exchanges in which they are members.[34]

In addition to the exceptions noted above, Rule 11a2-2(T) under the Act[35] provides exchange members with an exception from the prohibitions in Section 11(a). Rule 11a2-2(T), known as the "effect versus execute" rule, permits an exchange member, subject to certain conditions, to effect transactions for its own account, the account of an associated person, or an account with respect to which it or an associated person thereof exercises investment discretion (collectively, "covered accounts") by arranging for an unaffiliated member to execute the transactions on the exchange.

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32 15 U.S.C. 78k(a).

33 See, e.g., Securities Exchange Act Release No. 27205 (August 31, 1989), 54 FR 37180 (September 7, 1989) (Commission order approving a proposal of the Philadelphia Stock Exchange ("Phlx") relating to the crossing of agency orders). See also, e.g., Securities Exchange Act Release No. 33708 (March 3, 1994), 59 FR 11339 (March 10, 1994) (Commission order approving a proposal of the Midwest Stock Exchange, Inc. relating to agency crosses between the disseminated exchange market).

34 Section 11(a)(1)(A).

35 17 CFR 240.11a2-2(T).

To comply with the "effect versus execute" rule's conditions, a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[36] (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the rule.[37]

The Commission previously has found that the manner of operation of ISE's Facilitation Mechanism enables Exchange members to meet the conditions of the effect versus execute rule and thereby avail themselves of the exception that the rule provides from the prohibitions of Section 11(a).[38] Similarly, the Commission believes that the manner of operation of ISE's overall electronic trading system, not only the Facilitation Mechanism, enables members to meet the four conditions of the effect versus execute rule and would continue to do so under the proposal.[39] For this reason, the Commission believes that the proposed rule change, which

36 The member, however, may participate in clearing and settling the transaction. See Securities Exchange Act Release No. 14563, (March 14, 1978), 43 FR 11542 (March 17, 1978).

37 17 CFR 240.11a2-2(T).

38 See, e.g., Securities Exchange Act Release No. 51666 (May 9, 2005), 70 FR 25631 (May 13, 2005).

39 The Commission notes that, first, all orders are electronically submitted to the ISE through remote terminals. Second, because a member relinquishes control of its order after it is submitted to the system, the member does not receive special or unique trading advantages. Third, although the effect-versus-execute rule contemplates having an order executed by an exchange member who is not affiliated with the member initiating the order, the Commission recognizes that this requirement is satisfied when automated exchange facilities are used. (In considering the operation of automated execution systems operated by an exchange, the Commission has noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into the systems. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions

would permit orders of ISE members to be executed under certain circumstances even if a Professional Order is on the ISE's book, is consistent with the requirements of Section 11(a) of the Act and Rule 11a2-2(T) thereunder.

2. Protecting Investors and the Public Interest

In analyzing the merits of exchange proposals affecting public customer order priority, the Commission has considered whether the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires that the rules of an exchange, among other things, be designed "to protect investors and the public interest."[40]

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obtained through these systems satisfy the independent execution requirement of Rule 11a2–2(T). See Securities Exchange Act Release No. 15533 (January 29, 1979).) Finally, to the extent that ISE members rely on Rule 11a2–2(T) for a managed account transaction, they must comply with the limitations on compensation set forth in the rule. See id., at note 20.

40 For example, in January 1986, in publishing for public comment two proposed rule changes relating to the operation of RAES, see supra note 30, the Commission raised the question of whether the proposals were inconsistent with the provision in Section 6(b)(5) of the Act relating to the protection of investors and the public interest. The Commission also asked whether RAES was inconsistent with Section 11A of the Act, which states that it is in the public interest and appropriate for the protection of investors to assure "economically efficient execution of securities transactions," "the practicability of brokers executing investors' orders in the best market," and "an opportunity … for investors' orders to be executed without the participation of a dealer." 15 U.S.C. 78k-1(a)(1)(C)(i), (iv) and (v). On August 1, 1986, the Commission approved the proposal to make the RAES pilot program in OEX options permanent and a modified version of the pilot proposal for RAES in equity options, concluding that the proposed rule changes were consistent with the requirements of the Act, and, in particular, with Sections 6 and 11A of the Act. See Securities Exchange Act Release No. 23490 (August 1, 1986), 51 FR 28788 (August 11, 1986). In its approval order, the Commission stated that it was "cognizant of the substantial benefits provided by RAES to public customers of OEX and firms using the system" and noted that RAES had increased the efficiencies of the OEX market and added to the confidence of public customers. The Commission indicated that it expected CBOE to modify RAES for OEX options in the future, although it stated that its approval of the rule change was not tied to this expectation. Noting the technical impediments to modifying the system for such options, the Commission expressed its belief that "on balance, the benefits of RAES for the market in OEX weigh in favor of permanent approval."

The Commission does not believe that this provision of Section 6(b)(5) requires that ISE give priority to Public Customers whose orders would be considered Professional Orders under the proposal. The Commission has indicated in the past that it does not believe that priority for public customer orders is an essential attribute of an exchange. In particular, the Commission has approved options exchanges' trading rules that do not give priority to orders of public customers that are priced no better than the orders of other market participants.

For example, in approving proposed rules governing CBOEdirect, CBOE's electronic screen-based trading system ("SBT"), the Commission concluded that it was consistent with the Act for the CBOEdirect rules not to provide priority to public customer orders over market maker quotes and orders in all instances.[41] Significantly, the Commission noted in its approval order for the SBT rules that, in the rules governing trades on CBOE's floor, customer orders displayed on the limit order book are given priority over broker-dealer orders and market maker quotes, but distinguished the operation of CBOEdirect. On the floor, the Commission noted, the priority of booked customer limit orders was essential because (at the time) the DPM was the agent for orders resting in the limit order book and, therefore, consistent with general agency law principles, CBOE's rules accorded priority to those resting limit orders.[42] In contrast, an SBT market maker was not required to act as agent with respect to a limit order entered into CBOEdirect.

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41 CBOE had proposed alternative priority methodologies for its SBT system including public customer priority, market turner priority, and trade participation rights for Designated Primary Maket Makers ("DPMs") and Lead Market Makers. See Securities Exchange Act Release No. 47628 (April 3, 2003), 68 FR 17697 (April 10, 2003) (Commission order approving rules for CBOEdirect).

42 In 2005, the Commission approved a proposal by the CBOE to eliminate the requirement that DPMs act as the agent in the options in which it is registered as the DPM on the Exchange. See Securities Exchange Act Release No. 52798 (November 18, 2005), 70 FR 71344 (November 28, 2005) (Commission order approving removing agency responsibilities of DPMs).

Furthermore, on the Boston Options Exchange ("BOX"), the options facility of the Boston Stock Exchange, Inc., orders generally are executed according to price-time priority, with no distinctions made with regard to account designation (Public Customer, Broker/Dealer or Market Maker).[43] On the options facility of NYSE Arca, Inc. ("NYSE Arca"), all non-marketable limit orders and quotes also are ranked in an electronic limit order file and matched for execution according to price-time priority.[44] On these exchanges, all options orders at the best price are executed based on the time the order was entered. In approving these exchanges' rules, the Commission found them to be consistent with the Act.

The Commission believed that the BOX's and NYSE Arca's rules, which accord no priority to any public customer orders, are consistent with the Act's requirement that exchange rules be designed to protect investors and the public interest.[45] Similarly, the Commission believes that the ISE's proposal, which reasonably eliminates priority treatment of Professional Orders of Public Customers, is consistent with the statutory requirement.

3. Agency Obligations

In approving the proposed rule change, the Commission notes that, historically, exchange specialists have had substantial agency responsibilities in obtaining executions for customer limit orders. A specialist's responsibility to a customer in his or her role as agent for the limit order book was based on common law notions of fiduciary duty and incorporated in the rules of some

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43 The Commission stated that the "contention that all existing options exchanges provide strict customer priority is an overstatement." The Commission noted that several options exchanges had rules to permit market makers to be on parity with customer orders in certain circumstances. See Securities Exchange Act Release No. 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004).

44 See Securities Exchange Act Release No. 54238, (July 28, 2006), 71 FR 44758 (August 7, 2006) (Commission order approving NYSE Arca's OX Trading Platform).

45 Id.

exchanges. As exchanges increasingly have implemented automated trading systems, however, the specialist's role in handling limit orders has diminished.[46] On the ISE, market makers do not act as agent for incoming orders that are executable on the exchange. Orders submitted to the ISE are matched by an automated trading system and generally are not represented by a specialist acting as agent.[47]

The Commission's approval of ISE's proposal to no longer accord priority to Professional Orders is based solely on its determination that this proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange. The Commission is making no determination as to whether the failure of any market participant (e.g., a specialist managing an exchange's order book) to accord priority, as appropriate, to any order entrusted to that participant as an agent is consistent with the federal securities laws or any other applicable law. Accordingly, the Commission's approval of ISE's proposal does not affect fiduciary obligations under the federal securities laws or agency law principles.

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46 On several options exchanges, including BOX and CBOE, the exchange market makers have no responsibility for executing book orders, do not receive any fees for execution of book orders, and, accordingly, have no agency responsibilities for book orders. See e.g., BOX Rules, Chapter V and CBOE Rules Chapter VIII.

47 The Commission recognizes that ISE's rules mandate that a Public Customer Order be represented by an agent in a discrete situation. ISE Rule 803(c) requires Primary Market Makers ("PMMs"), as soon as practical, to address Public Customer Orders that are not automatically executed because there is a displayed bid or offer on another exchange trading the same option contract that is better than the best bid or offer on the Exchange. In such cases, PMMs are required to execute at a price that matches the best price displayed on another exchange and/or send a Linkage Order. However, ISE Rule 803(c), which pertains to Intermarket Linkage, would not be affected by the proposed rule change. As noted above, ISE rules relating to the Intermarket Linkage affecting Public Customers would continue to apply to all Public Customers – even those customers whose orders are identified as Professional Orders. See supra note 18 and accompanying text.

B. Issues Raised by Commenters

As noted above, the Commission has received ten comment letters regarding the proposed rule change.[48] Nine of these commenters opposed the proposal. One commenter endorsed the ultimate goal of the proposal, but expressed concerns regarding its implementation.[49] The Commission acknowledges the arguments and concerns that have been raised by the commenters, but believes that the arguments and concerns do not support the conclusion that the proposal is inconsistent with the Act.

The commenters raise essentially five main issues: (1) that the proposal is anti-competitive; (2) that it unfairly discriminates against certain Public Customers who no longer would have priority over Non-Customers; (3) that it raises technical and operational issues for firms; (4) that it is vague and therefore unenforceable; and (5) that the imposition of transaction fees for the execution of Professional Orders is unfair. In its review of the proposal, the Commission has carefully considered these issues and has evaluated them in light of the Act's provisions, as discussed below.

1. ISE's Proposal Does Not Impose an Unnecessary or Inappropriate Burden on Competition

Some commenters believed that the proposed rule change would thwart competition by treating the orders of certain Public Customers on a par with orders of broker-dealers, despite the inability of those customers to participate in the market on an equal footing with broker-dealers and market makers.[50] These commenters argued that broker-dealers and market makers have substantial marketplace advantages over Public Customers, including lower margin and

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48 See supra note 4.

49 See SIFMA Letter, supra note 4.

50 See, e.g., Cox Letter I supra note 4 and Weisberg Letter supra note 4.

commission rates, better access to information, and superior technology,[51] and, in the case of market makers, the ability to stream quotes electronically on both sides of the market.[52]

As discussed above, the Act does not require that the order of a public customer or any other market participant be granted priority. The objective of promoting competition and the requirement that the rules of an exchange not impose an unnecessary or inappropriate burden upon competition do not necessarily mandate that a Professional Order be granted priority while the order of a broker-dealer should not be granted the same right.

As a general matter, in developing their trading and business models, exchanges have adopted rules, with Commission approval, that grant priority to certain participants over others, or to waive fees or provide discounts for certain kinds of transactions, in order to attract order flow or create more competitive markets.

The Act itself recognizes that the operation of a marketplace can warrant exceptions to general allocation principles, for example, by exempting specialists and market makers from the requirement that a member of an exchange yield to the order of a non-member.[53] "Specialist entitlements"[54] and facilitation and solicited order guarantees,[55] adopted by exchanges with

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51 See, e.g., Carr Letter supra note 4, G. Schneider Letter supra note 4 and Rule Letter supra note 4.

52 See, e.g., Carr Letter supra note 4, Cox Letter II supra note 4 and Rule Letter supra note 4.

53 See Section 11(a) of the Act, 15 U.S.C. 78k(a), and the rules thereunder.

54 A "specialist entitlement" as used here is an options exchange rule that under certain circumstances guarantees a specialist (or designated primary market maker) the right to trade ahead of other participants in the trading crowd with a certain percentage of every order – when the specialist is quoting at the best price – even when the specialist has not otherwise established priority. See, e.g., ISE Rule 713, Supplementary Material .01(b); Amex Rule 935-ANTE(a)(5); CBOE Rule 8.87; NYSE Arca Rule 6.82(d)(2); Phlx Rule 1014(g)(ii).

55 A "facilitation guarantee" as used here is an options exchange rule that under certain circumstances guarantees an order entry firm that has submitted a public customer order

Commission approval, also are instances in which the need to attract order flow or provide incentives to one group of participants based on their role in the marketplace has been viewed as a valid reason to adjust the otherwise-established priority principles of an exchange. Other examples include options trading rules that adjust allocation principles under certain condition in the execution of larger orders[56] and the small order automatic execution systems created by options exchanges in the past.[57] Notably, in some prior proposals to waive or reduce customer fees, exchanges cited their need to remain competitive and attract order flow.[58]

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for execution on the exchange to trade with a certain percentage of that public customer order itself, ahead of other participants in the trading crowd that are prepared to trade at the same price. See, e.g., ISE Rule 716(d); Amex Rule 950-ANTE, Commentary .02; CBOE Rule 6.74(b); NYSE Arca Rule 6.47(b); A "solicited order guarantee" is an options exchange rule that entitles a broker or firm that has solicited an order from a third party to trade against its customer's order to execute a certain percentage of the customer's order against the solicited order ahead of other participants in the trading crowd that are prepared to trade at the same price. See, e.g., ISE Rule 716(e) (Solicited Order Mechanism).

56 See, e.g., CBOE Rule 6.74(f) (Open Outcry SizeQuote Mechanism).

57 In the past, options exchanges that generally operated on an open-outcry trading model adopted systems that automatically executed orders of public customers below a certain size without exposing them to the auction on the floor. These systems were designed to give investors speed, efficiency, and accuracy in the execution of their small orders, which were executed at the exchange's disseminated quotation on a rotational basis against the accounts of participating market makers. Auto-ex orders were thus not executed according to auction principles and priority rules, but were allocated to market makers on the system by turn, regardless of who was first to bid or offer the disseminated price. For descriptions of such systems, see, e.g., Securities Exchange Act Release Nos. 48975 (December 23, 2003), 68 FR 75667 (December 31, 2003) (Amex); 44829 (September 21, 2001), 66 FR 49730 (September 28, 2001) (Phlx); 41823 (September 1, 1999), 64 FR 49265 (September 10, 1999) (Pacific Exchange); and 44104 (March 26, 2001), 66 FR 18127 (April 5, 2001) (CBOE).

58 See, e.g., Securities Exchange Act Release Nos. 50469 (September 29, 2004), 69 FR 59628 (October 5, 2004) (CBOE reduction of public customer transaction fees on options on ETFs and HOLDRs); 49957 (July 1, 2004), 69 FR 41318 (July 8, 2004) (ISE waiver of surcharge on public customer transactions in certain licensed products); 44654 (August 3, 2001), 66 FR 42574 (August 13, 2001) (CBOE waiver of fees for public customer transactions in options on Standard & Poor's 100 European-style index). See also infra, note 101.

The Commission believes that ISE's proposal to grant priority only to Priority Customers and no longer to waive fees for transactions involving Professional Orders likewise does not necessarily place an inappropriate burden on competition and should most reasonably be viewed as within the discretion of the Exchange,[59] so long as these changes do not unfairly discriminate among participants.[60] In fact, the ISE's proposal simply restores the treatment of Professional Orders to a base line where no special priority benefits and fee waivers are granted.

Moreover, with respect to commenters' contention that broker-dealers have substantial marketplace advantages over Public Customers, it should be noted that broker-dealers, unlike Public Customers, pay significant sums for registration and membership in self-regulatory organizations ("SROs"), and incur significant costs to comply, and ensure that their associated persons comply, with the Act and the rules thereunder and SRO rules. Moreover, Public

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59 The Commission previously has articulated its position regarding its application of Section 6 of the Act in evaluating distinctions among market participants proposed by exchanges and the leeway granted to an exchange to set an appropriate level of advantages and responsibilities of persons in its marketplace. See Securities Exchange Act Release No. 50484 (October 1, 2004), 69 FR 60440 (October 8, 2004), stating, inter alia:

> [Section (b)(5)] sets forth the purposes or objectives that the rules of a national securities exchange should be designed to achieve. Those purposes or objectives, which take the form of positive goals, such as to protect investors and the public interest, or prohibitions, such as to not permit unfair discrimination among customers, issuers, brokers or dealers or to not permit any unnecessary or inappropriate burden on competition, are stated as broad and elastic concepts. They afford the Commission considerable discretion to use its judgment and knowledge in determining whether a proposed rule change complies with the requirements of the Act. Furthermore, the subsections of Section 6(b) of the Act must be read with reference to one another and to other applicable provisions of the Act and the rules thereunder. Within this framework, the Commission must weigh and balance the proposed rule change, assess the views and arguments of commenters, and make predictive judgments about the consequences of approving the proposed rule. (citations omitted)

60 See infra Section III.B.2 for a discussion of whether ISE's proposal is unfairly discriminatory.

Customers who would not be Priority Customers on ISE because they place options orders on the scale contemplated by the proposal could choose to become registered broker-dealers and receive the same advantages.

With regard to commenters' contentions relating to market-maker advantages, the Commission notes that ISE market makers have obligations that customers who seek to compete with them do not have, including the responsibility to make continuous markets; to engage in a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market; and not to make bids or offers or enter into transactions that are inconsistent with such a course of dealings.[61] Generally, the advantages of market makers noted by commenters, such as the ability to stream quotes on two sides of the market, are granted by exchanges as the quid pro quo for the market makers' assumption of these obligations, in addition to the application of other rules and restrictions relating to their activities.[62]

In addition, the proposal could provide an advantage to Public Customers who would not be Priority Customers. Under the proposed rule change, Professional Orders would not be subject to cancellation fees,[63] which could result in partially reduced costs for those customers who place orders on an average of one order per minute and frequently cancel such orders.[64]

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61 See ISE Rule 803.

62 For example, pursuant to ISE Rule 803(b), a market maker on ISE has a continuous obligation to engage, to a reasonable degree under the existing circumstances, in dealings for the market maker's own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular options contract, or a temporary distortion of the price relationships between options contracts of the same class. Public Customers, including customers who seek to compete with market makers, have no such obligations. Under ISE's proposal, Public Customers who submit Professional Orders would not be subject to market maker obligations.

63 The Exchange charges a cancellation fee, currently $2.00 per cancellation, on each clearing EAM that cancels at least 500 Public Customer orders in a month for itself or for an introducing broker, for each cancelled order in excess of the total number of orders

Several commenters stated that active traders provide valuable liquidity to the market and pose significant competition to market makers. According to some commenters, the proposed rule change would punish these customers who contribute liquidity,[65] and would force such traders from the market.[66]

The Commission acknowledges that Public Customers, including sophisticated algorithmic traders, provide valuable liquidity to the options markets and compete with market makers. In the Commission's view, however, the contribution of these participants to the market does not mean that their orders are entitled to favorable priority and fee treatment, even if – as commenters argue – they would not be able to supply this liquidity without being granted such priority and fee advantages. Market makers and broker-dealers also provide valuable liquidity to the marketplace and do not have priority. Thus, the Commission believes that it is consistent with the Act for the ISE to amend its rules so that Professional Orders, like the orders of broker-dealers and market makers, are not granted special priority.

Two commenters appeared to acknowledge that customers who enter orders on the scale that the proposed rule change would establish likely have information and technology that allows them to compete in a sophisticated manner.[67] However, they argued that the proposal's creation

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executed for itself or for such introducing broker that month. The cancellation fee does not apply to the cancellation of Public Customer Orders that improve ISE's disseminated quote at the time the orders were entered. There currently are no fees for the cancellation of Non-Customer Orders, and Professional Orders would not incur such fees under the proposed rule change.

64 The Commission notes that, contrary to the apparent belief of some commenters, the proposal would not impose cancellation fees on Professional Orders. See Cox Letter II supra note 4 and Carr Letter supra note 4.

65 See, e.g., A. Schneider Letter supra note 4 and Weisberg Letter supra note 4.

66 See, e.g., Lampert Letter supra note 4.

67 See, e.g., Carr Letter supra note 4 and Cox Letter II supra note 4.

of the category of Professional Orders suggests that "any person who wishes to consider themselves a retail customer [must] forego any type of trading technology, which of course is widely available in today's market ...."[68]

The Commission disagrees with this contention. The proposed rule does not ask Public Customers to forego technology and does not limit the technology that Public Customers who would not be Priority Customers can use to access the ISE's marketplace. Rather, it establishes that customers who place orders at the level proposed by the ISE – irrespective of their use of trading technology – are engaged in a course of active trading that need not be accorded the special deference paid to those customers who do not place orders as frequently.

In support of its proposal, the ISE contends that traders who place orders on the scale set forth in the proposal have the same technological and informational advantages over retail investors as broker-dealers trading for their own account – which enables them to compete effectively with broker-dealer orders and market maker quotes for execution opportunities in the ISE marketplace.[69] The Commission, however, does not believe that access to or use of sophisticated technology is the key issue in considering whether it is consistent with the Act for ISE to treat Professional Orders in the same manner as broker-dealer orders in specified circumstances. Instead, the Commission believes that the pivotal issue is whether, under the Act, the exchange can grant certain advantages, which it initially established for all public customers, to only those public customers who place no more than 390 orders per day.

The Commission notes that currently customers who are positioned to place orders in the number and frequency specified in the proposed rule change are treated on a par with customers

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68 See Carr Letter supra note 4. The commenter believed that the proposal, as a result, would require retail customers who forego technology to "wander into the marketplace blind and helpless."

69 See Notice, supra note 3, at 73 FR 7346.

who may not have this ability, or even if they have this ability, do not place orders on the average of one order per minute per over the trading day. Under the Exchange's proposal, customers who place orders less frequently would be advantaged by the Exchange's grant of priority over Non-Customer Orders and market maker quotes at the same price, even if they have access to sophisticated options trading technology. Further, the Commission disagrees with the argument that customers would have to forego using trading technology under the Exchange's proposal. The ISE's proposal does not limit, prohibit, or proscribe the type of technology any customer uses. Customers could still use sophisticated technology to trade options and their orders would not be considered Professional Orders, as long as those customers placed fewer than one order per minute per day on average during a calendar month for their own beneficial account(s).

One commenter believed that the proposed rule change limited competition and was collusive because "it requires the cooperation of other competing exchanges. . . ."[70] The Commission notes, however, that the proposed rule change requires EAMs to conduct a quarterly review of customer activity only as reflected in the EAM's own records. The proposal does not require either EAMs or the Exchange to seek information from other broker-dealer firms or exchanges regarding a customer's activity.[71]

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70 See Cox Letter III supra note 4. The commenter stated further: ". . . I fail to see how the ISE can request trading information from a person or entity trading from another exchange, particularly when other exchanges have business models that promote order entry: the exact behavior the ISE is attempting to punish with its rule."

71 Confirmed in telephone conversation between Ira Brandriss, Special Counsel, Division, Commission, and Katherine Simmons, Deputy General Counsel, ISE, on April 29, 2008. See also supra note 17 and accompanying text. See also ISE Rules 401, 706, and 712.

2. ISE's Proposal Is Not Unfairly Discriminatory

Many of the commenters argued that the proposed rule change is unfairly discriminatory against those Public Customers who would not be Priority Customers by denying them priority rights and imposing transaction fees on their orders.[72] In the ISE's view, public customers today range from individuals who infrequently place options orders to sophisticated algorithmic traders that trade many options classes on a daily basis.[73] ISE proposes to continue to grant priority to, and waive transaction fees for, individuals who place orders below the threshold, as a means to encourage their participation. The Exchange believes, however, that priority rights and fee waivers are no longer warranted for market participants who place more than one order per minute on average during a calendar month, a level of activity that it believes is akin to that of broker-dealers. The Exchange therefore proposes to refrain from providing priority and fee incentives for such participants.

The Commission notes that the Act does not require that the Exchange's rules be designed to prohibit all discrimination, but rather they must not permit unfair discrimination.[74] With regard to public customer priority, the Commission has noted above ample precedent demonstrating that public customer orders are not entitled per se to priority treatment over the orders of other market participants. The Commission similarly believes that the ISE's proposal to grant such priority treatment only to Priority Customers is consistent with the Act and, in particular, is not unfairly discriminatory.

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72 See, e.g., G. Schneider Letter supra note 4, Lampert Letter supra note 4, Rule Letter supra note 4, Cox Letter II supra note 4 and Cox Letter III supra note 4.

73 See Notice, supra note 3, at 73 FR 7346.

74 15 U.S.C. 78f(b)(5). See also Securities Exchange Act Release No. 50484, supra note 59.

As discussed above, the Commission does not believe that the current rules of ISE and other exchanges that accord priority to all public customers over broker-dealers and market makers are unfairly discriminatory. Nor does the Commission believe that it is unfairly discriminatory to accord priority to only those customers who on average do not place more than one order per minute as ISE proposes.

Because, as discussed in Section III.A.1. above, the Commission believes that ISE's proposal is consistent with the Act in that it does not impose an undue burden on competition, the Commission believes that a grant of such priority is an exchange's prerogative and within the exchange's business judgment. As such, a decision to grant priority – which, after all, is a special benefit – to the orders of one type of customer (for example, a retail customer) and not to the orders of another (for example, an institutional investor) may be an economic decision that an exchange may make to provide some customers with incentives and fee waivers. In the Commission's view, nothing in the Act requires an exchange to provide the same incentives and discounts to all market participants equally, as long as the exchange does not unfairly discriminate among participants with regard to access to exchange systems.[75]

The Commission believes that the line that the ISE seeks to draw between Priority Customers and Public Customers whose orders would be treated as Professional Orders most simply reflects a belief – from the point of view of operating a marketplace – that the orders of a person who submits, on average, more than one order every minute of the trading day need not (or should not) be granted the same benefit or incentive that is granted to Public Customers who do not utilize the marketplace on such a scale.

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[75] In this regard, the Commission notes that ISE amended the proposal to remove the changes it had originally proposed to ISE Rules 715 and 723(c), which would have prevented access by all Public Customers to the Exchange's PIM. See Amendment No. 2, supra note 5.

The same can be said with regard to relief from transaction fees. Exchanges can and do have fee structures that vary depending on the market participant.[76] Various fee structures are permitted provided that they are consistent with the Act (including the requirement that the fees not be unfairly discriminatory). Such differing fee structures are based on the judgment of those responsible for the financial operation of the exchange, and are tied to exchange assumptions about market participant behavior, the impact of incentives and discounts, and other factors relating to the specific business model adopted by the exchange. A decision to waive or discount fees for orders of one kind of participant and not another, based on the extent of their participation in the market, is a reasonable decision for an exchange, provided it is otherwise consistent with the Act.[77]

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76 For example, some exchanges impose different fees for different market participants, depending on whether the market participant adds liquidity by posting a quote or order, or takes liquidity by executing against a quote or order that is already posted on the exchange. Some exchanges' transaction fees, before additional charges are assessed, are identical for market makers and member firms, while on other exchanges market makers and member firms are charged at different rates. Some exchanges provide volume discounts; some place a cap on charges to particular participants. Some impose transaction fees upon certain participants for complex orders; others do not. As a result, the fees imposed upon various market participants can vary significantly from exchange to exchange. Each exchange's schedule of fees is available on the exchange's website. See e.g., the fee schedule of CBOE at http://www.cboe.com/AboutCBOE/FeeSchedule.aspx; the fee schedule of BOX at http://www.bostonoptions.com/box_regulations/PDF/feeschedjan06.pdf ; and the fee schedule of NYSE Arca at http://www.nyse.com/futuresoptions/nysearcaoptions/1147128317287.html.

77 Similar to other exchanges, ISE charges different fees depending on whether an individual is a Public Customer, Non-Member Broker-Dealer, EAM, ISE Market Maker or Non-ISE Market Maker. For example, ISE charges Public Customers a $0.05 fee for Non-Premium Products and the $0.03 Comparison Fee for the orders of Public Customers are currently waived while Non-Member Broker-Dealers and EAMs pay a $0.15 fee for orders in Premium and Non-Premium Products (subject to volume discounts) and a $0.03 Comparison Fee. Comparatively, ISE market makers are subject to a fee for transactions in Premium and Non-Premium Products between $0.12-$0.21 (subject to volume discounts). The amount of this fee is based on the average daily

3. The Proposal Can be Implemented on a Technical and Operational Level

One commenter, SIFMA, endorsed the underlying goal of the proposed rule change, but expressed concern about various aspects of the proposal. First, SIFMA was concerned that, under the proposed rule, EAMs would "have no ability to identify the end-user customer and count orders."[78] SIFMA's comment letter noted that EAMs would have to rely on the broker-dealers that route orders to them and have the customer relationship to identify the professional customer and code orders correctly. Moreover, SIFMA stated that, in general, firms do not count the number of orders directed by customers under the same beneficial owners and do not have the ability to break down, by beneficial owner, the number of orders placed. SIFMA further believed that EAMs would need to rely on the Options Clearing Corporation ("OCC") member firm that ultimately clears the professional customer to identify such accounts. SIFMA stated, however, that such reliance would not be possible because OCC member clearing firms see only the number of cleared contracts at the end of the day, and not the number of executions. Moreover, SIFMA noted the lack of access by clearing firms to information regarding a customer's cancellations, replacements, modifications, or corrections of orders, and the resulting inability of such firms to accurately determine the number of orders a customer has placed.[79]

In its response, ISE stated that these concerns were based on the erroneous assumption that compliance with the proposal would require analysis by an ISE member's clearing firm of cleared data provided by the OCC to determine whether a customer had crossed the threshold of

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volume of transactions on the Exchange, and is currently $0.13 per contract. See ISE Schedule of Fees. See also discussion infra note 105.

78 See SIFMA Letter supra note 4.

79 Id.

placing more than 390 orders per day, on average, over the course of a calendar month.[80] ISE clarified that only broker-dealers that received orders from the ultimate customers – not clearing firms – would be required under the proposal to monitor the number of orders they receive from each such customer and to mark the orders correctly. "These types of activities are routinely performed by broker-dealers who deal directly with customers," the ISE maintained, adding that broker-dealers have a regulatory responsibility to know their customer, "and, in fact, do know if they have customers that conduct this high level of activity."[81]

With regard to ISE members that submit customer orders to the Exchange when those orders were routed to them by other, non-ISE-member broker-dealers, SIFMA indicated its concern that such members "will be forced to rely on the good faith and effort of its broker-dealer client ... to identify the professional customer and code the order correctly."[82] In response, the ISE noted that the Exchange and all other options exchanges currently have a variety of order marking requirements for which ISE members that route orders on behalf of other broker-dealers have regulatory responsibility. The ISE further noted that its EAMs would need to have reasonable procedures in place to confirm that their broker-dealer customers had implemented the appropriate procedures to monitor their customers' trading activity in a way that would enable them to code orders properly to comply with the proposal.[83]

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80 See ISE Response Letter supra note 6.

81 Id. The ISE also stated that it consulted with a variety of firms that accept orders directly from customers, and that these firms did not believe it would be difficult for them to determine, on a quarterly look-back basis, whether a customer had on average entered more than 390 orders per day during any month. Id.

82 See SIFMA Letter supra note 4.

83 Id. According to the Exchange, an EAM would be required to have such procedures in place to comply with its obligation under ISE Rule 712(a) to properly mark orders. Telephone conversation between Katherine Simmons, Deputy General Counsel, ISE, and

The Commission believes that the ISE's response clarifies its proposal and addresses the concerns raised by SIFMA regarding the counting and marking of customer orders. The proposal would require any ISE member submitting a Public Customer Order to the ISE to identify such order as either a Priority Customer Order or a Professional Customer Order. Based on the ISE's representations, the Commission believes that ISE members that directly submit their Public Customers' orders to the Exchange for execution can readily determine the number of orders that their customers place and can mark those orders accordingly. The Commission notes that the Exchange has stated that EAMs would need to have reasonable procedures in place to confirm that their broker-dealer customers have instituted policies and procedures to enable them to monitor their customers' trading activity in a way that would allow them to mark their customer orders properly.[84]

The Commission believes that ISE members, as well as non-member broker-dealers who accept customer orders and route them to EAMs for execution on the Exchange, have the ability to ascertain for each customer account, by beneficial owner, the number of orders placed by a customer. As the ISE points out, the proposal requires the broker-dealer that has a relationship with, and knows, the ultimate customer to monitor the number of orders it is entering on the customer's behalf and to conduct a quarterly review to assure that the firm is marking the orders appropriately. This monitoring is accomplished by the ISE member directly in the case of its own customers or by the ISE member contractually requiring that its broker-dealer customers have reasonable procedures in place to ascertain whether their customers are submitting orders that should be marked as Professional Orders.

Nancy J. Burke-Sanow, Assistant Director, Division, Commission, on December 15, 2008.

84 Id.

Second, SIFMA expressed concern that professional customers could "'game' the system and inappropriately take advantage and avoid the purpose of the rule." SIFMA noted the frequent use by Professional Customers of multiple firms for execution and clearing purposes, which would limit the review by any one EAM or OCC clearing member of a customer's activity. SIFMA further noted that customers could electronically route orders to an exchange without a Professional Order designation and, due to linkage and best execution requirements, these orders could be sent to the ISE without the proper coding.[85] ISE acknowledged that customers could place orders at multiple firms, such that each individual broker-dealer would not know the full extent of its customer's trading activity, making it impossible for a particular firm to measure the total number of orders entered by a particular customer through multiple firms. ISE stated, however, that it believed that "it might be impractical for a customer to conduct professional trading activities through multiple broker-dealer platforms." The Exchange also stated that it would conduct surveillance designed to identify any such behavior, and that if it does detect such activity, it would alert the relevant ISE members. In addition, ISE agreed that, through the operation of the options linkage rules, an order for the account of a customer that ISE otherwise would consider a Professional Order might be routed to other exchanges that do not have the same order designation and ultimately receive the price available on the ISE indirectly.[86] The Commission believes that the rule change, as proposed, meets the Exchange's aim with regard to those customers who do not employ such stratagems, and thus the potential for a customer to circumvent the proposed rule, does not, in this instance, make it inconsistent with the Act.

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85 See SIFMA Letter supra note 4.

86 See ISE Response Letter supra note 6.

Third, SIFMA believed that, for the proposed rule change to be properly implemented, customer trading information would need to be disseminated across desks within a single firm that typically are separated by information barriers. Regarding this issue, SIFMA requested specific guidance on how to implement the proposed requirements without violating applicable privacy regulations.[87] ISE responded that putting procedures in place to comply with its proposal would not result in disclosure of information about particular orders entered by a customer either pre- or post-trade, nor would it result in disclosures about any positions held by a customer. The Exchange stated that it is not aware of any information barrier rule or privacy regulations that would prevent a firm from marking an order as required under the proposal.[88] The Commission agrees with the ISE's position in this regard. The Commission believes that the determination of whether a Public Customer's orders are categorized as Priority Customer Orders or Professional Orders, which would be based on information compiled retrospectively each quarter, can be made at a level in the firm that is "above" the information barrier, and in any case does not require disclosure of any particular orders placed by a customer or any positions held by a customer.

Finally, one commenter expressed the concern that the proposal would be burdensome because it would require EAMs to purchase expensive technology to track the number of orders a person entered per day.[89] Another commenter, SIFMA, believed that the ISE's proposal would require broker-dealers to expend significant resources to comply with the rule and potentially

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87 See SIFMA Letter supra note 4.

88 See ISE Response Letter supra note 6.

89 See Cox Letter III supra note 4.

would present large retail firms with difficulties in implementing a new order origin code within the proposal's timeframe.[90]

ISE acknowledged that systems changes to accommodate new coding of orders could be required for some broker-dealers, but did not believe that such systems changes would be particularly costly "relative to other rule changes routinely made by the ISE and other exchanges."[91] SIFMA also expressed a concern that the proposal could require significant revisions to the customer option account agreements used by firms, because customers could be designated as professional customers.[92] The Commission believes that it is within the business judgment of the Exchange to accept orders for execution in its marketplace contingent upon their submission with a particular order marking, even when that marking may require additional expense on the part of member firms. Exchanges routinely add new order types[93] and the ISE's proposal is no different in this regard. Thus, the Commission believes that the new order designations in the proposed rule change are consistent with the Act, even though they will require members to incur costs associated with systems changes and customer account agreements may need to be revised to reflect these new order designations. As a general matter, the Commission notes that membership in an exchange comes with the expectation that rule changes will be made by the exchange that could require member firms to make adjustments in their systems and procedures.

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90 See SIFMA Letter, supra note 4.

91 See ISE Response Letter supra note 6.

92 See SIFMA Letter supra note 4.

93 See, e.g., Securities Exchange Act Release Nos. 58546 (September 15, 2008), 73 FR 54440 (September 19, 2008); 57441 (March 6, 2008), 73 FR 13267 (March 20, 2008); and 56072 (July 13, 2007), 72 FR 39867 (July 20, 2007).

SIFMA further noted that the proposal would require additional systemic and procedural enhancements for firms to track the new fees that would be established under the proposal.[94] In response, the Exchange maintained that fees vary widely among exchanges and are changed frequently, and that firms routinely make changes in their systems to accommodate exchange fee changes.[95] The Commission notes that fee changes are commonly introduced by exchanges, and members can expect that they will need to adjust their tracking systems as needed when changes are made.

Finally, SIFMA further expressed a concern that the five-day timeframe allotted at the end of a quarter for firms to start coding for Priority Customer and Professional Orders is unrealistic.[96] In response, the ISE acknowledged that it may take more than five days for a broker-dealer to make the system changes necessary to accommodate the new order code, and stated that it would give members at least one full quarter, following Commission approval of the proposal to make these changes. The Exchange stated, however, that once the initial systems changes were implemented, five days would be sufficient to change the order code associated with a particular customer account.[97] The Commission notes that the Exchange has committed to working with its members to assure that there is adequate time to make the initial systems changes necessary to implement the new coding,[98] and believes that not less than one full quarter

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94 See SIFMA Letter supra note 4.

95 See ISE Response Letter supra note 6.

96 See SIFMA Letter supra note 4.

97 See ISE Response Letter supra note 6.

98 The Exchange stated that it would work with its members to assure that there is adequate time to implement systems changes as necessary. ISE Response Letter, supra note 6, n.6. The Exchange further advised that it would issue a notice to its members informing them of the implementation date of the proposed rule change. Telephone conversation between Katherine Simmons, Deputy General Counsel, ISE, and Nancy J. Burke-Sanow, Assistant Director, Division, Commission, on December 15, 2008.

is a reasonable amount of time to achieve this aim. The Commission, however, will monitor whether any issues may arise that would require the ISE to postpone the proposal's implementation timeframe.

4. ISE's Proposal Is Not Vague

One commenter contended that the proposal was vague and unenforceable.[99] The Commission believes that the ISE's proposed rule change is amply clear regarding the kind of order that would not receive priority at the same price and would incur transaction fees as a result of the proposal. The proposal sets forth specific and objective numeric thresholds in its provisions, defining "Priority Customer" as "a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s)." It further defines the term "Professional Order" as "an order that is for the account of a person or entity that is not a Priority Customer." The Commission believes that these definitions are clear and provide notice of the parameters of the rule.

5. Transaction Fees for Professional Orders Are Not Inequitable

As noted above, Section 6(b)(4) of the Act requires that the rules of an exchange must provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. In evaluating whether a proposed fee can be considered an equitable allocation of a reasonable fee, the Commission considers all of the relevant factors including, among others, the amount of the fee and whether the fee is an increase or decrease, the classes of persons subject to the fee, the basis for any distinctions in

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99 See Cox Letter III, supra note 4.

classes of persons subject to the fee, the potential impact on competition, and the impact of any disparate treatment on the goals of the Act.[100]

Under the proposed rule change, transaction fees would be charged for the execution of certain Public Customer Orders that currently are not subject to such fees. The Commission notes, however, that options exchanges have charged transaction fees for the execution of public customer orders in the past,[101] and in many cases continue do so when necessary to defray the costs of maintaining a market and associated expenses for a particular product or category of products.[102] The ISE itself currently imposes fees on certain Public Customer Orders.[103]

Moreover, Public Customer Orders that today incur no transaction fees on the ISE are not indefinitely excepted from such fees. The Exchange's Fee Schedule specifically sets forth transaction fees for customer orders, while indicating that these fees (other than fees for "Premium Products") currently are waived.[104] The Commission notes that different market

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100 See, e.g., Securities Exchange Act Release No. 50484 (October 1, 2004), 69 FR 60440 (October 8, 2004).

101 Subsequently, however, some exchanges have rescinded transaction fees for manually executed equity options orders for public customers. See, e.g., Securities Exchange Act Release Nos. 42798 (May 18, 2000), 65 FR 34239 (May 26, 2000); and 43343 (September 26, 2000), 65 FR 59243 (October 4, 2000).

102 For example, the exchanges generally charge transaction fees for executions of public customer orders in index options. See, e.g., Securities Exchange Act Release No. 52983 (December 20, 2005), 70 FR 76475 (December 27, 2005) (Commission notice of filing and immediate effectiveness of a proposed rule change adopting a flat execution fee for Public Customer Orders in premium products).

103 As noted at supra note 9, Public Customer Orders incur fees for certain transactions in Premium Products and Complex Orders, orders entered in response to special order broadcasts, and orders entered in PIM. Public Customer Orders also are subject to fees for cancellation.

104 See Securities Exchange Act Release Nos. 42370 (April 28, 2000), 65 FR 26256 (May 5, 2000) (Commission order adopting original ISE Fee Schedule), in which the Commission found that the fee schedule was "not unreasonable" and "should not discriminate unfairly among market participants." See also the current ISE Fee Schedule, dated August 12, 2008 and Securities Exchange Act Release No. 58139 (July 10, 2008), 73 FR 41142 (July

participants pay fees based on their status on the Exchange (e.g., Public Customer, non-member broker-dealer, EAM, non-ISE market maker and ISE market maker).[105] Under the proposal, customers whose orders are identified as Professional Orders would pay the same fees as non-member broker-dealers.

17, 2008) (customer fees, except those for "Premium Products," currently waived until June 30, 2009).

105 Public Customers - The $0.05 fee for Non-Premium Products and the $0.03 Comparison Fee for the orders of Public Customers are currently waived. Public Customers currently pay a fee of $0.15 for certain orders in Premium Products and Complex Orders, orders entered in response to special order broadcasts and orders entered in PIM. Public Customers are also subject to an order cancellation fee of $1.75 per order. See supra notes 9 and 64.

Non-member Broker-Dealers - Non-member broker-dealers pay a $0.15 fee for orders in Premium and Non-Premium Products (subject to volume discounts) and a $0.03 Comparison Fee. Customers whose orders are identified as Professional Orders would incur these fees under the proposal.

EAMs - EAMs pay the same fees for orders as non-member broker-dealers. In addition to non-member broker-dealer fees, EAMs also pay a one time application fee of $3500, a regulatory fee of $5000 per year and a monthly access fee of $500.

ISE Market Makers - ISE market makers are subject to a fee for transactions in Premium and Non-Premium Products between $0.12-$0.21 (subject to volume discounts). The amount of this fee is based on the average daily volume of transactions on the Exchange, and is currently $0.13 per contract. See Fee Notice to ISE Members dated March 3, 2008, available at http://www.iseoptions.com. In addition, ISE market makers pay a $0.03 Comparison Fee, a fee for payment for order flow (only for customer orders) of $0.65 per contract and $0.10 per contract for options on issues that are participating in the Penny Pilot (subject to available rebates).

In addition to these market maker fees, PMMs and Competitive Market Makers ("CMMs") pay additional fees including, but not limited to, the fees described below. PMMs have a minimum monthly transaction fee of $50,000, a one time application fee of $7500, a regulatory fee of $7500 per year, a monthly access fee of $4000 and an inactivity fee of $100,000 per month. CMMs have a one time application fee of $5500, a regulatory fee of $5000 per year, a monthly access fee of $2000 and an inactivity fee of $5,000 per month.

Non-ISE Market Makers - Non-ISE market makers pay a $0.37 fee for transactions in Premium and Non-Premium Products (subject to volume discounts) except for a $0.16 fee for orders entered in the Facilitation and Solicitation Mechanisms and a $0.03 Comparison Fee.

The Commission notes that the customers who enter more than 390 orders per day on average during a calendar month are using the Exchange's facilities to place approximately 8000 orders, on average one order for every minute of every trading day, over the course of the month and nearly 100,000 orders per year. The Commission believes that it is consistent with the Act for ISE to allocate to customers who participate in the market at this level of activity – which enables them to compete with Non-Customers who are registered broker-dealers – the same transaction fees that it charges to such Non-Customers.

C. Accelerated Approval of Proposed Rule Change, As Modified by Amendment Nos. 1 and 2

Pursuant to Section 19(b)(2) of the Act,[106] the Commission may not approve any proposed rule change, or amendment thereto, prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding. The Commission hereby finds good cause for approving the proposed rule change, as modified by Amendment Nos. 1 and 2, before the 30th day after the date of publication of notice of filing thereof in the Federal Register.[107] The Commission notes that the proposal, as modified by Amendment No. 1, was published for comment in the Federal Register on February 7, 2008. The revisions made to the proposal in Amendment No. 2 deleted proposed changes to ISE Rules 715 and ISE Rule 723 (d)(2). These revisions appropriately clarify that the proposed rule change would not limit a Public Customer's access to the Exchange's PIM. Accordingly, pursuant to Section 19(b)(2) of the Act,[108] the Commission finds good cause to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

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106 15 U.S.C. 78s(b)(2).

107 See supra note 3.

108 15 U.S.C. 78s(b)(2).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment Nos. 1 and 2, is 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-ISE-2006-26 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2006-26. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet 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 the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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. 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2006-26 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[109] that the proposed rule change (SR-ISE-2006-26), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved on an accelerated basis.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

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109 15 U.S.C. 78s(b)(2).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 29, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13354

In the Matter of Leading Edge Packaging, Inc., Leadingside, Inc., Lecstar Corp., and Legal Club of America, Inc., Respondents.	ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Leading Edge Packaging, Inc., Leadingside, Inc., Lecstar Corp., and Legal Club of America, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Leading Edge Packaging, Inc. (CIK No. 1021549) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Leading Edge Packaging is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1999, which reported a net loss of $1,942,000 for the prior nine months. As of January 27, 2009, the company's stock (symbol "LEPI") was quoted on the Pink Sheets, operated by Pink OTC Markets, Inc. ("Pink Sheets"), had two market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

2. Leadingside, Inc. (CIK No. 875942) is a dissolved Delaware corporation located in Cambridge, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Leadingside is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a

10-Q for the period ended September 30, 2000, which reported a net loss of $15,720,000 for the prior nine months. As of January 27, 2009, the company's stock (symbol "LDSD") was quoted on the Pink Sheets, had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

3. Lecstar Corp. (CIK No. 949485) is a delinquent Texas corporation located in Atlanta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lecstar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $18,342,531 for the prior nine months. As of January 27, 2009, the company's stock (symbol "LCST") was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

4. Legal Club of America, Inc. (CIK No. 1080403) is a Colorado corporation located in Plantation, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Legal Club of America is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2004, which reported a net loss of $955,000 for the prior nine months. As of January 27, 2009, the company's stock (symbol "LEGL") was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Attachment

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Appendix 1

Chart of Delinquent Filings
Leading Edge Packaging, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Leading Edge Packaging, Inc.					
	10-K	03/31/00	06/29/00	Not filed	103
	10-Q	06/30/00	08/14/00	Not filed	101
	10-Q	09/30/00	11/14/00	Not filed	98
	10-Q	12/31/00	02/14/01	Not filed	95
	10-K	03/31/01	06/29/01	Not filed	91
	10-Q	06/30/01	08/14/01	Not filed	89
	10-Q	09/30/01	11/14/01	Not filed	86
	10-Q	12/31/01	02/14/02	Not filed	83
	10-K	03/31/02	07/01/02	Not filed	78
	10-Q	06/30/02	08/14/02	Not filed	77
	10-Q	09/30/02	11/14/02	Not filed	74
	10-Q	12/31/02	02/14/03	Not filed	71
	10-K	03/31/03	06/30/03	Not filed	67
	10-Q	06/30/03	08/14/03	Not filed	65
	10-Q	09/30/03	11/14/03	Not filed	62
	10-Q	12/31/03	02/17/04	Not filed	59
	10-K	03/31/04	06/29/04	Not filed	55
	10-Q	06/30/04	08/16/04	Not filed	53
	10-Q	09/30/04	11/15/04	Not filed	50
	10-Q	12/31/04	02/14/05	Not filed	47
	10-K	03/31/05	06/29/05	Not filed	43
	10-Q	06/30/05	08/15/05	Not filed	41
	10-Q	09/30/05	11/14/05	Not filed	38
	10-Q	12/31/05	02/14/06	Not filed	35
	10-K	03/31/06	06/29/06	Not filed	31
	10-Q	06/30/06	08/14/06	Not filed	29
	10-Q	09/30/06	11/14/06	Not filed	26
	10-Q	12/31/06	02/14/07	Not filed	23
	10-K	03/31/07	06/29/07	Not filed	19
	10-Q	06/30/07	08/14/07	Not filed	17
	10-Q	09/30/07	11/14/07	Not filed	14
	10-Q	12/31/07	02/14/08	Not filed	11
	10-K	03/31/08	06/30/08	Not filed	7

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Leading Edge Packaging, Inc.					
	10-Q	06/30/08	08/14/08	Not filed	5
	10-Q	09/30/08	11/14/08	Not filed	2
Total Filings Delinquent	**35**				
Leadingside, Inc.					
	10-K	12/31/00	04/02/01	Not filed	93
	10-Q	03/31/01	05/15/01	Not filed	92
	10-Q	06/30/01	08/14/01	Not filed	89
	10-Q	09/30/01	11/14/01	Not filed	86
	10-K	12/31/01	04/01/02	Not filed	81
	10-Q	03/31/02	05/15/02	Not filed	80
	10-Q	06/30/02	08/14/02	Not filed	77
	10-Q	09/30/02	11/14/02	Not filed	74
	10-K	12/31/02	03/31/03	Not filed	70
	10-Q	03/31/03	05/15/03	Not filed	68
	10-Q	06/30/03	08/14/03	Not filed	65
	10-Q	09/30/03	11/14/03	Not filed	62
	10-K	12/31/03	03/30/04	Not filed	58
	10-Q	03/31/04	05/17/04	Not filed	56
	10-Q	06/30/04	08/16/04	Not filed	53
	10-Q	09/30/04	11/15/04	Not filed	50
	10-K	12/31/04	03/31/05	Not filed	46
	10-Q	03/31/05	05/16/05	Not filed	44
	10-Q	06/30/05	08/15/05	Not filed	41
	10-Q	09/30/05	11/14/05	Not filed	38
	10-K	12/31/05	03/31/06	Not filed	34
	10-Q	03/31/06	05/15/06	Not filed	32
	10-Q	06/30/06	08/14/06	Not filed	29
	10-Q	09/30/06	11/14/06	Not filed	26
	10-K	12/31/06	04/02/07	Not filed	21
	10-Q	03/31/07	05/15/07	Not filed	20
	10-Q	06/30/07	08/14/07	Not filed	17
	10-Q	09/30/07	11/14/07	Not filed	14
	10-K	12/31/07	03/31/08	Not filed	10
	10-Q	03/31/08	05/15/08	Not filed	8
	10-Q	06/30/08	08/14/08	Not filed	5

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Leadingside, Inc.					
	10-Q	09/30/08	11/14/08	Not filed	2
Total Filings Delinquent	32				
Lecstar Corp.					
	10-KSB	12/31/02	03/31/03	Not filed	70
	10-QSB	03/31/03	05/15/03	Not filed	68
	10-QSB	06/30/03	08/14/03	Not filed	65
	10-QSB	09/30/03	11/14/03	Not filed	62
	10-KSB	12/31/03	03/30/04	Not filed	58
	10-QSB	03/31/04	05/17/04	Not filed	56
	10-QSB	06/30/04	08/16/04	Not filed	53
	10-QSB	09/30/04	11/15/04	Not filed	50
	10-KSB	12/31/04	03/31/05	Not filed	46
	10-QSB	03/31/05	05/16/05	Not filed	44
	10-QSB	06/30/05	08/15/05	Not filed	41
	10-QSB	09/30/05	11/14/05	Not filed	38
	10-KSB	12/31/05	03/31/06	Not filed	34
	10-QSB	03/31/06	05/15/06	Not filed	32
	10-QSB	06/30/06	08/14/06	Not filed	29
	10-QSB	09/30/06	11/14/06	Not filed	26
	10-KSB	12/31/06	04/02/07	Not filed	21
	10-QSB	03/31/07	05/15/07	Not filed	20
	10-QSB	06/30/07	08/14/07	Not filed	17
	10-QSB	09/30/07	11/14/07	Not filed	14
	10-KSB	12/31/07	03/31/08	Not filed	10
	10-Q[1]	03/31/08	05/15/08	Not filed	8
	10-Q[1]	06/30/08	08/14/08	Not filed	5
	10-Q[1]	09/30/08	11/14/08	Not filed	2
Total Filings Delinquent	24				
Legal Club of America, Inc.					
	10-KSB	06/30/04	9/28/04	Not filed	52
	10-QSB	09/30/04	11/15/04	Not filed	50
	10-QSB	12/31/04	2/14/05	Not filed	47

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Legal Club of America, Inc.					
	10-QSB	03/31/05	5/16/05	Not filed	44
	10-KSB	06/30/05	9/28/05	Not filed	40
	10-QSB	09/30/05	11/14/05	Not filed	38
	10-QSB	12/31/05	2/14/06	Not filed	35
	10-QSB	03/31/06	5/15/06	Not filed	32
	10-KSB	06/30/06	9/28/06	Not filed	28
	10-QSB	09/30/06	11/14/06	Not filed	26
	10-QSB	12/31/06	2/14/07	Not filed	23
	10-QSB	03/31/07	5/15/07	Not filed	20
	10-KSB	06/30/07	9/28/07	Not filed	16
	10-QSB	09/30/07	11/14/07	Not filed	14
	10-QSB	12/31/07	2/14/08	Not filed	11
	10-QSB	03/31/08	05/15/08	Not filed	8
	10-KSB	06/30/08	9/28/08	Not filed	4
	10-Q [1]	09/30/08	11/14/08	Not filed	2

Total Filings Delinquent **18**

[1]Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, are in the process of being removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal is taking effect over a transition period that will conclude on March 15, 2009, so by that date, all reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB will be required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) will have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 29, 2009

IN THE MATTER OF Leading Edge Packaging, Inc., Leadingside, Inc., Lecstar Corp., and Legal Club of America, Inc., File No. 500-1	:	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Leading Edge Packaging, Inc. because it has not filed any periodic reports since the period ended December 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Leadingside, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Lecstar Corp. because it has not filed any periodic reports since the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Legal Club of America, Inc. because it has not filed any periodic reports since the period ended March 31, 2004.

3 of 3

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 29, 2009, through 11:59 p.m. EST on February 11, 2009.

By the Commission.

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

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 **January 2009**, 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.
Mary L . Schapiro was sworn in as SEC Chairman on January 27, 2009.

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

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

8 Documents

Commissioner Casey and
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2835 / January 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13358

In the Matter of **Jeffrey Swanson,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO JEFFREY SWANSON**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Jeffrey Swanson ("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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

From at least 2002 through 2005, Merrill Lynch Pierce Fenner & Smith, through its pension consulting services advisory program, breached its fiduciary duty to the firm's pension fund clients and prospective clients by misrepresenting and omitting to disclose material information. During this time period, Respondent was an investment adviser representative for Merrill Lynch, and in that capacity owed a fiduciary duty to his clients. Respondent's clients included public pension funds seeking advice in developing appropriate investment strategies and in selecting money managers to manage the assets entrusted to their care. In providing such advice, Respondent made misleading statements to some of the firm's pension consulting clients regarding the process by which Merrill Lynch assisted them in identifying new managers. As a result, Respondent aided and abetted and caused Merrill Lynch's violation of Section 206(2) of the Advisers Act.

B. RESPONDENT AND OTHER RELEVANT PARTIES

Jeffrey Swanson – age 42, of Jacksonville Beach, Florida was an investment adviser representative for Merrill Lynch from March 1994 to December 31, 2006. In October 2006, he resigned from Merrill Lynch. During the relevant time period, Respondent worked out of Merrill Lynch's Jacksonville office with a team of ten Merrill Lynch employees to provide advisory services to over 100 public pension clients in Florida. This group moved to office space in Ponte Vedra Beach in 2004 (the "Ponte Vedra office").

Merrill Lynch Pierce Fenner & Smith ("Merrill Lynch") – is the wholly-owned principal operating subsidiary of the holding company, Merrill Lynch & Co. Merrill Lynch has been registered with the Commission as a broker-dealer since March 12, 1959 and as an investment adviser since December 8, 1978.

Merrill Lynch Consulting Services ("Consulting Services") – is an advisory program offered under the auspices of Merrill Lynch's Wealth Management Group, and provides advisory services to high net worth and institutional clients, including public pension funds. The headquarters are in Jersey City, New Jersey.

C. FACTS

From 2002 through at least 2005, Merrill Lynch, through its Consulting Services program, provided advisory services to high net worth and institutional clients, including public pension funds. As an integral part of these services, it assisted clients in developing appropriate

[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.

investment policies and in identifying asset allocations to meet their individual needs. Merrill Lynch also monitored and evaluated clients' existing money managers to ensure that the managers' performances and investment styles remained consistent with the clients' investment objectives. It also helped clients to identify and evaluate new money managers so that the clients could select one or more such managers for the discretionary management of their accounts.

During the relevant time period, Respondent, an investment adviser representative in Merrill Lynch's Ponte Vedra office, worked with a team of Merrill Lynch employees to provide services to public pension fund clients in Florida, including many municipal employees, police and firefighters' pension funds. The headquarters for Merrill Lynch Consulting Services was located in Jersey City, New Jersey, and provided support to this office and to other investment adviser representatives throughout the country who provided advisory services.

During the relevant time period, Merrill Lynch and Respondent misrepresented the process used to identify managers for clients in breach of their fiduciary duty to those clients. Merrill Lynch, in written communications, and Respondent, in oral statements, emphasized the extensive in-house resources and research that would be available through Merrill Lynch to match each individual client with appropriate money managers for that client's needs. Their descriptions of these services, however, did not accurately describe the services that Merrill Lynch and Respondent were actually providing to the Ponte Vedra office's clients.

The Merrill Lynch disclosure statements provided to clients, as well as responses to client Requests for Proposals ("RFPs"), highlighted the extensive Merrill Lynch process that would be brought to bear on money manager selections for each client. These documents, taken together, described the typical procedure for selecting a new money manager as follows: A client would send a questionnaire, through its investment adviser representative, to Consulting Services headquarters in New Jersey, providing information regarding, among other things, the client's investment objectives and risk tolerance for the portfolio intended to be managed by the new manager. An investment manager research analyst in the Consulting Services offices in New Jersey would then compare the questionnaire against data about investment managers available to Merrill Lynch from a variety of sources, including both nonproprietary databases and subscription services, and generate a preliminary list of potential investment managers whose investment processes and styles appeared to be compatible with the client's financial objectives and requirements. The analyst would then apply various criteria to reduce the preliminary list to a group of typically three to five investment managers that appeared appropriate for the client. Merrill Lynch Consulting Services offices in New Jersey would then provide the requesting investment adviser representative with a list of managers and written background information on each manager, which would in turn be presented to the client. The documents provided to clients and potential clients regarding this service repeatedly refer to Merrill Lynch's large research staff and capabilities, giving the impression that those resources are deployed for every client's manager search.

Respondent's descriptions of these services to clients and prospective clients were consistent with the Merrill Lynch written materials. In presenting the manager identification service to clients and potential clients, he emphasized the breadth of resources available through the New Jersey Consulting Services offices that would be available to a client in choosing a new manager. Respondent also emphasized that the performance-based reviews and quantitative and qualitative analyses conducted by the New Jersey Consulting Services offices on potential money managers would be tailored to fit the client's specific needs.

The Ponte Vedra office's procedures for performing manager searches, however, deviated from these descriptions. The New Jersey Consulting Services offices did not select potential money managers for Respondent's clients based on their specific needs. Rather, from approximately 2002 through 2005, members of Merrill Lynch's Ponte Vedra office conducted the manager search process themselves using a short list (the "Ponte Vedra list") of managers, which had been developed by the Ponte Vedra office. The Ponte Vedra list consisted of approximately sixty money managers from Merrill Lynch's vast approved list. The Ponte Vedra list was divided into ten or eleven categories of managers, each containing approximately six money managers, therefore potentially giving rise to a limited universe of recommendations. When one of Respondent's clients requested a new manager search, an associate in the Ponte Vedra office, working at Respondent's direction, would refer to the pre-existing Ponte Vedra list, obtain information on the managers on the list from publicly available databases, and compile this information into a booklet to be presented to the client. These search reports were not reviewed by Consulting Services headquarters in New Jersey. Rather, Respondent decided which managers from the Ponte Vedra list to present to his clients. In at least one instance regarding direct real estate investment managers, Respondent recommended money managers that he knew had not been screened by the New Jersey Consulting Services office and were not on the Merrill Lynch approved list. Respondent knew that these managers had been reviewed and placed on the Ponte Vedra list by the head of the Ponte Vedra office.

D. DISCUSSION

By making misleading statements to some of the firm's pension consulting clients, as discussed above, Merrill Lynch violated Section 206(2) of the Advisers Act, which provides that "[i]t shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[2] As a result of the conduct described above, Respondent willfully[3] aided and abetted and caused Merrill Lynch's violation of Section 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 Respondent Swanson's Offer.

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2 Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963).

3 A willful violation of the securities laws means merely "'that the person charged with the violation knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)).

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

A. Respondent is hereby censured; and

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

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey and
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9004 / January 30, 2009

Administrative Proceeding
File No. 3-13357

In the Matter of **Merrill Lynch, Pierce, Fenner & Smith Inc.,** **Respondent.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION.**

Merrill Lynch, Pierce, Fenner & Smith Inc.("Merrill Lynch") has submitted a letter, dated January 15, 2009, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from Merrill Lynch's settlement of an administrative proceeding commenced by the Commission.

On January 30, 2009, pursuant to Merrill Lynch's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order As to Merrill Lynch, Pierce, Fenner & Smith Inc. Under the Order, the Commission found that Merrill Lynch willfully violated Sections 204 and 206(2) of the Investment Advisers Act of 1940 by breaching its fiduciary duty to certain of the firm's pension fund clients and prospective clients by misrepresenting and omitting to disclose material information to its clients, failing reasonably to supervise its investment adviser representatives in its Ponte Vedra South office with respect to the provision of advisory services to its advisory clients, and failing to maintain records of the offer and delivery of disclosure statements to its clients. In the Order, the Commission ordered that Merrill Lynch be censured, cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(2) of the Advisers Act, and Rule 204-2(a)(14) thereunder, and pay a civil money penalty of $1 million to the United States Treasury.

2 of 8

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 203(d) or (e) of the Investment Advisers Act of 1940. Rule 602(e) of the Securities Act of 1933 ("Securities Act") provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

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

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey and Commissioner Paredes Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9003 / January 30, 2009

Securities Exchange Act of 1934
Release No. 59330 / January 30, 2009

Administrative Proceeding
File No. 3-13357

In the Matter of **Merrill Lynch, Pierce, Fenner & Smith Inc.,** **Respondent.**	**ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933, AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934**

Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") has submitted a letter, dated January 15, 2009, requesting a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from the settlement of an administrative proceeding with the Commission. On January 30, 2009, pursuant to Merrill Lynch's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order As to Merrill Lynch, Pierce, Fenner & Smith Inc.

Under the Order, the Commission found that Merrill Lynch willfully violated Sections 204 and 206(2) of the Investment Advisers Act of 1940 by breaching its fiduciary duty to certain of the firm's pension fund clients and prospective clients by misrepresenting and omitting to disclose material information to its clients, failing reasonably to supervise its investment adviser representatives in its Ponte Vedra South office with respect to the provision of advisory services to its advisory clients, and failing to maintain records of the offer and delivery of disclosure statements to its clients. In the Order, the Commission ordered that Merrill Lynch be censured, cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(2) of the Advisers Act, and Rule 204-2(a)(14) thereunder, and pay a civil money penalty of $1 million to the United States Treasury.

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

Based on the representations set forth in Merrill Lynch's January 15, 2009, request letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the issuance of the Commission's Order Instituting Administrative and Cease-and-Desist Proceedings is appropriate and should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act, and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Merrill Lynch resulting from the Commission's Order Instituting Administrative and Cease-and-Desist Proceedings is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

J Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey and
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2834 / January 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13357

In the Matter of Merrill Lynch, Pierce, Fenner & Smith Inc., Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AS TO MERRILL LYNCH, PIERCE, FENNER & SMITH INC.**

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 Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch" or "Respondent").

II.

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

4 of 8

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

From at least 2002 through 2005, Merrill Lynch, through its pension consulting services advisory program, breached its fiduciary duty to certain of the firm's pension fund clients and prospective clients by misrepresenting and omitting to disclose material information. Merrill Lynch's pension fund clients came to it seeking advice in developing appropriate investment strategies and in selecting money managers to manage the assets entrusted to their care. In providing such advice, Merrill Lynch failed to disclose the facts creating the material conflict of interest in recommending clients use directed brokerage to pay hard dollar fees, and in recommending the use of Merrill Lynch's transition management desk. In addition, Merrill Lynch made misleading statements to the clients served by its Ponte Vedra South, Florida office ("Ponte Vedra South office") regarding its manager identification process. As a result of the above conduct, Merrill Lynch violated Section 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"). In addition, Merrill Lynch failed reasonably to supervise its investment adviser representatives in the Ponte Vedra South office with respect to the provision of advisory services to its Consulting Services clients. Finally, Merrill Lynch violated Section 204 of the Advisers Act and Rule 204-2(a)(14) thereunder by failing to maintain records of the offer or delivery of disclosure statements.

B. RESPONDENT AND OTHER RELEVANT ENTITIES

Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") – is the wholly-owned principal operating subsidiary of the holding company, Merrill Lynch & Co. As of January 1, 2009, Merrill Lynch & Co. is a direct subsidiary of Bank of America Corporation. Merrill Lynch has been registered with the Commission as a broker-dealer since March 12, 1959 and as an investment adviser since December 8, 1978.

Merrill Lynch Consulting Services – is an advisory program offered under the auspices of Merrill Lynch's Global Wealth Management Group, and provides advisory services to high net worth and institutional clients, including public pension funds.

Merrill Lynch's Ponte Vedra South office ("Ponte Vedra South office") – Merrill Lynch's Ponte Vedra South, Florida office had close to 100 public pension clients in Florida and a team of approximately ten Merrill Lynch employees, including four investment adviser representatives, who provided services to those clients. Prior to 2005, this group operated out of Merrill Lynch's Jacksonville, Florida office.

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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.

C. FACTS

From at least 2002 through 2005 (the "relevant time period"), Merrill Lynch, through its Consulting Services program, provided advisory services to high net worth and institutional clients, including public pension funds. As an integral part of these services, Merrill Lynch assisted clients in developing appropriate investment policies and in determining asset allocations to meet their individual needs. Merrill Lynch also monitored Consulting Services clients' existing money managers to provide information to clients on whether the managers' performances remained consistent with the clients' investment objectives. It also helped clients to identify and evaluate new money managers so that the clients could select one or more such managers for the discretionary management of their accounts.

During the relevant time period, Merrill Lynch's Ponte Vedra South office had close to 100 public pension fund clients in Florida, including many municipal employee, police and firefighters' pension funds. A team of ten Merrill Lynch employees, including several investment adviser representatives, provided services to these clients. The headquarters for Merrill Lynch Consulting Services was located in Jersey City, New Jersey, and provided support to this office and other investment adviser representatives who provided advisory services.

During the relevant time period, Merrill Lynch generated a Consulting Services Disclosure Statement furnished to clients in lieu of Form ADV Part II, as permitted by the Advisers Act Rule 204-3(a). Pursuant to Rule 203-1(b)(2), this document is considered filed with the Commission.

Merrill Lynch Made Material Misrepresentations

During the relevant time period, Merrill Lynch misrepresented the process used to identify managers for clients of the Ponte Vedra South office in breach of its fiduciary duty to those clients. Merrill Lynch, in written communications, emphasized the extensive in-house resources and research that would be available through Merrill Lynch to match each individual client with appropriate money managers for that client's needs. Their descriptions of these services, however, did not accurately describe the services that the Ponte Vedra South office was actually providing to its clients.

The Merrill Lynch disclosure statements provided to clients, as well as responses to client Requests for Proposals ("RFPs"), highlighted the extensive Merrill Lynch process that would be brought to bear on money manager selections for each client. These documents, taken together, described the typical procedure for identifying new money managers as follows: a client would send a questionnaire, through its investment adviser representative, to Merrill Lynch Consulting Services headquarters in New Jersey, providing information regarding, among other things, the client's investment objectives and risk tolerance for the portfolio intended to be managed by the new manager. An investment manager research analyst in the Merrill Lynch Consulting Services offices in New Jersey would then compare the questionnaire against data about investment managers available to Merrill Lynch from a variety of sources, including, among others, both nonproprietary databases and subscription services, and generate a preliminary list of potential investment managers whose investment processes and styles appeared to be compatible with the client's financial objectives and requirements. The analyst would then apply various criteria to reduce the preliminary list to a group of typically five to eight investment managers that appeared appropriate for the client. Merrill Lynch Consulting Services offices in New Jersey would then provide the requesting investment adviser representative with a booklet containing a list of managers and written background information on each manager, which would in turn be presented to the client. The documents provided to clients and potential clients regarding this service repeatedly refer to Merrill Lynch's large research staff and capabilities, giving the impression that those resources are deployed for every client's money manager search. In addition to these disclosures, members of the Ponte Vedra South office also sent letters to clients highlighting the benefits of Merrill Lynch's extensive research capabilities. These letters were reviewed by Merrill Lynch supervisors.

The Ponte Vedra South office's procedures for performing manager searches, however, deviated from the described process. The Merrill Lynch Consulting Services offices did not identify potential money managers for the Ponte Vedra South office's clients. Rather, from approximately 2002 through 2005, members of the Ponte Vedra South office conducted the manager search process themselves using a short list (the "Ponte Vedra South list") of managers, which had been developed by the Ponte Vedra South office. The Ponte Vedra South list consisted of approximately sixty money managers primarily from Merrill Lynch's vast approved lists. The Ponte Vedra South list was divided into ten or eleven categories of managers, each containing approximately six money managers, therefore potentially giving rise to a limited universe of recommendations. When one of the Ponte Vedra South office's clients requested a new manager search, an associate in the Ponte Vedra South office would refer to the pre-existing Ponte Vedra South list, seek input from the Ponte Vedra South office investment adviser representative who serviced the requesting client and sometimes from Merrill Lynch Consulting Services in New Jersey, obtain information on the managers on the list from publicly available and subscription databases, and compile this information into a booklet to be presented to the client. These search reports were not reviewed by Merrill Lynch Consulting Services headquarters in New Jersey. Rather, an investment adviser representative in the Ponte Vedra South office decided, sometimes with non-client specific input from Merrill Lynch Consulting Services, which managers from the Ponte Vedra South list to present to his clients. In addition to representing only a subset of the money managers vetted and approved by Merrill Lynch Consulting Services, the Ponte Vedra South list also included – and members of the Ponte Vedra South office recommended – certain money managers who had not been vetted and approved by Merrill Lynch Consulting Services. The New Jersey Consulting Services office was aware that the investment adviser representatives in the Ponte Vedra South office recommended money managers who had not been vetted, and that its manager identification process deviated from disclosures clients received about that process.

As a result of the conduct described above, Merrill Lynch willfully[2] violated Section 206(2) of the Advisers Act, which provides that "[i]t shall be unlawful for any investment adviser, by use

[2] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977

of the mails or any means or instrumentality of interstate commerce, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[3]

Merrill Lynch Failed to Disclose Certain Conflicts of
Interest to its Clients and Potential Clients

During the relevant time period, Merrill Lynch charged for the advisory services provided through Merrill Lynch Consulting Services on a fixed-fee basis. Clients could pay in cash (referred to as "hard dollars") or through "directed brokerage." Directed brokerage was an arrangement whereby the clients directed their money managers to execute trades through Merrill Lynch's institutional trading desk, consistent with the managers' best execution obligations. In return, in addition to execution services, these clients received credit for a portion of the commissions generated by these trades against the hard dollar fee owed for the advisory services provided by Merrill Lynch Consulting Services. Even after the hard dollar fee had been satisfied, Merrill Lynch Consulting Services, and its investment adviser representatives, continued to receive a portion of the commissions generated through the directed brokerage relationship. In negotiating fees and payment arrangements with their clients, many of whom were not knowledgeable about their trading options, the investment adviser representatives in the Ponte Vedra South office recommended that the clients establish a directed brokerage relationship with Merrill Lynch. The majority of the Ponte Vedra South office Consulting Services clients elected to enter directed brokerage relationships. Clients who established directed brokerage relationships often were given a lower hard dollar fee than they would have received if they had not established such a relationship.

Under Merrill Lynch's standard directed brokerage relationship, Merrill Lynch Consulting Services and, consequently, its investment adviser representatives potentially could receive and, in fact, often did receive significantly more revenues through directed brokerage commissions than they would have received if clients had paid brokerage commissions for trade executions elsewhere and paid Merrill Lynch only the hard-dollar annual Consulting Services fee. For example, in one instance in the Ponte Vedra South office a client who was obligated to pay a $7500 annual hard dollar fee for the advisory services it received through Merrill Lynch Consulting Services generated almost $175,000 in production credits[4] by executing trades at Merrill Lynch. Other examples in that office include a client generating $65,000 in production credits for trade executions with a hard dollar fee of $7500 and another client generating production credits of $145,000 for trade executions with a hard dollar fee of $32,000. Beginning in 2004, the Ponte Vedra South office disclosed the amount of each client's hard dollar fee and the amount of directed

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(D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

3 Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 195 (1963).

4 Production credits represent the portion of the commissions the clients paid to Merrill Lynch for brokerage services that were shared in by Merrill Lynch Consulting Services and its investment adviser representatives.

brokerage commissions generated by the client. Prior to November 2005, Merrill Lynch's disclosures for Consulting Services clients failed to disclose the fact that Merrill Lynch Consulting Services and, consequently, its investment adviser representatives might have a financial incentive to recommend that its clients enter into a directed brokerage relationship.

During the relevant time period, Merrill Lynch also failed to inform its Consulting Services clients that Merrill Lynch's Global Wealth Management Group and, consequently, its investment adviser representatives had a direct financial incentive to recommend that clients use Merrill Lynch for transition management services. Transition management was a service offered by Merrill Lynch's Transition Management group, a separate unit of Merrill Lynch, to clients in the process of terminating one money manager and hiring another. Without the services of a transition manager, the money manager being terminated would sell the shares held by the fund that the new money manager did not want in its portfolio and transfer the proceeds from those sales to the client's account. The new money manager would then use these proceeds to purchase securities for its portfolio on behalf of the client. Consequently the process of terminating and hiring a new manager resulted in the generation of commissions. Merrill Lynch's transition management group represented that it could manage a transition more efficiently and cost-effectively by offering cross trades and reduced commission costs. Moreover, beginning in 2003, Merrill Lynch Consulting Services actively promoted the use of Merrill Lynch's transition management services to its Consulting Services clients. Between July 2000 and the end of 2005, more than nine Ponte Vedra South office Consulting Services clients used Merrill Lynch for transition management services on at least 19 separate occasions.

Merrill Lynch's Global Wealth Management Group directly benefited from the Consulting Services clients' use of the Merrill Lynch transition management services and generally received 1¢ per share in production credits from the Transition Management group for every transitioned share. For example, one transition generated production credits of slightly over $150,000 and another generated production credits of more than $38,000. The Global Wealth Management Group's financial interest in Consulting Services clients' use of the Merrill Lynch transition management service created a potential conflict of interest when its investment adviser representatives recommended that service. Because during the relevant period the fact that the Global Wealth Management Group benefited from Consulting Services' recommendation to use transition services was not disclosed to the clients, the clients were unable to evaluate whether the recommendation of Merrill Lynch's Transition Management services was disinterested.

Investment advisers, such as Merrill Lynch, owe fiduciary duties to their clients and, therefore, must, among other things, disclose all actual or potential conflicts of interest.[5] In

[5] Capital Gains, 375 U.S. at 191, 196-97 (1963) ("The Investment Advisers Act of 1940 thus reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship . . . . An investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether the adviser is serving two masters or only one, especially if one happens to be economic self-interest."); In re O'Brien Partners, Inc., Advisers Act Release No. 1772 (Oct. 27, 1998)(" . . . since even potential conflicts of interest are material and must be disclosed, [the investment adviser] was required to disclose its receipt of third-party payments, even if it had concluded that the payments did not influence the manner in which it advised its clients."); In the Matter of Feeley & Willcox Asset Management Corp., Advisers Act Release No. 2143 (July 10, 2003) ("It is the client, not the

addition, investment professionals who advise pension funds must be aware of the important role that pension plans play in the financial security of the beneficiaries.

As a result of the conduct described above, Merrill Lynch willfully violated Section 206(2) of the Advisers Act, which provides that "[i]t shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

Merrill Lynch Failed to Supervise its Ponte Vedra South Investment Adviser Representatives Offering Consulting Services

During the relevant time period, Merrill Lynch did not reasonably supervise certain of the investment adviser representatives in the Ponte Vedra South office with a view to preventing violations of the federal securities laws. The supervisory structure of the investment adviser representatives was not well-delineated. Branch level supervisors believed that the Merrill Lynch Consulting Services offices in New Jersey were responsible for supervising most aspects of the investment adviser representatives' provision of advisory services, while Merrill Lynch Consulting Services personnel in New Jersey believed that this responsibility rested with the local managers. This left a vacuum in supervision of the Ponte Vedra South office, where the procedures that existed for supervising that office were not being adequately enforced. An example of the lax controls is the fact that the Ponte Vedra South office maintained its own computer server, the contents of which the local managers never reviewed. Merrill Lynch Consulting Services was not aware of its existence. Moreover, to the extent Merrill Lynch Consulting Services personnel were aware of the activities of the Ponte Vedra South office, they allowed its practices to deviate from standard Merrill Lynch Consulting Services procedure, which led to violations of the Advisers Act. Specifically, the Ponte Vedra South office conducted its own manager identification searches, recommended money managers who had not been vetted and used a short list for recommendations. These practices were inconsistent with disclosures about the manager identification process provided to clients and prospective clients.

In addition, Merrill Lynch did little to train its investment adviser representatives about their duties to advisory clients. This lack of oversight and inadequate training allowed for an environment in which the investment adviser representatives in the Ponte Vedra South office were permitted to act in a manner that was inconsistent with the duty owed to their clients and resulted, in part, in the failure to disclose conflicts of interest.

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adviser, who is entitled to make the determination whether to waive the adviser's conflict. Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate, much less waive, the conflict.").

Based on the foregoing conduct, Merrill Lynch failed reasonably to supervise certain investment adviser representatives in the Ponte Vedra South office who aided and abetted Merrill Lynch's violations of Section 206(2) of the Advisers Act, with a view to preventing violations of the Advisers Act.

Merrill Lynch Did Not Maintain Adequate Records

During the relevant time period, as mentioned above, Merrill Lynch generated a Consulting Services Disclosure Statement furnished to clients in lieu of Form ADV Part II, as permitted by the Advisers Act Rule 204-3(a). Until December 2005, however, Merrill Lynch Consulting Services did not maintain a record of the delivery of the Disclosure Statements to its clients. As a result of this conduct, Merrill Lynch willfully violated Section 204 of the Advisers Act, and Rule 204-2 (a)(14) promulgated thereunder, which requires that investment advisers registered with the Commission maintain and preserve certain books and records. Rule 204-2 (a)(14) requires that registered investment advisers keep "a copy of each written statement and each amendment or revision thereof, given or sent to any client or prospective client . . . and a record of the dates that each written statement . . . was given, or offered to be given . . . ."

Merrill Lynch's Remedial Efforts

In determining to accept the Offer, the Commission considered voluntary and significant remedial acts promptly undertaken by Respondent.

IV.

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

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

A. Merrill Lynch is censured;

B. Merrill Lynch cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(2) of the Advisers Act, and Rule 204-2(a)(14) thereunder; and

C. Merrill Lynch shall, within 90 days of the entry of this Order, pay a civil money penalty in the amount of $1 million 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 Merrill Lynch 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 Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey and
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13356

In the Matter of **MICHAEL A. CALLAWAY,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), against Michael A. Callaway ("Respondent" or "Callaway").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent was employed by Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch"), as a registered investment adviser, from 1976 to 2008. During the relevant period, respondent was Senior Vice President and Financial Advisor, an investment adviser representative, and head of a team of approximately ten Merrill Lynch employees, including three other investment adviser representatives, which provided advisory services to approximately 100 public pension fund clients in Florida. During the relevant period, Merrill Lynch was also a registered broker-dealer and Respondent was licensed with FINRA as a registered representative of the Merrill Lynch broker-dealer. Respondent, 56 years old, is a resident of Ponte Vedra, Florida.

B. OTHER RELEVANT ENTITIES[1]

2. **Merrill Lynch** is the wholly-owned principal operating subsidiary of the holding company, Merrill Lynch & Co. Merrill Lynch has been registered with the Commission as a broker-dealer since March 12, 1959, and as an investment adviser since December 8, 1978.

3. **Merrill Lynch Consulting Services** is an advisory program offered under the auspices of Merrill Lynch's Global Wealth Management Group, and provides advisory services to high net worth and institutional clients, including public pension funds.

4. **The Callaway Team** was a team of approximately ten Merrill Lynch employees headed by Respondent. It included four investment adviser representatives, who were also associated with the Merrill Lynch broker-dealer. The team provided advisory services to approximately 100 public pension clients in Florida. Until 2005, this group operated out of Merrill Lynch's Jacksonville, Florida office. In 2005, the group moved to Merrill Lynch's Ponte Vedra South office.

C. FACTS

5. From at least 2000 through 2005 ("the relevant period"), Merrill Lynch, through its Consulting Services program, provided advisory services to high net worth and institutional clients, including public pension funds. As an integral part of these services, it assisted clients in developing appropriate investment policies and in identifying asset allocations to meet their individual needs. Merrill Lynch Consulting Services also helped clients to monitor performance of their investment portfolios by providing periodic reports and helped clients to identify and evaluate new money managers so that the clients could select one or more such managers for the discretionary management of their accounts.

6. During the relevant period, Respondent, as part of the Merrill Lynch Consulting Services program, and the Callaway Team provided advisory services to close to 100 public pension fund clients in Florida, including many municipal employees, police and firefighters' pension funds. The headquarters for Merrill Lynch Consulting Services was located in Jersey City, New Jersey, and provided support to this office and to other investment adviser representatives throughout the country who provided advisory services.

7. Under Section 206 of the Advisers Act, an investment adviser may not make materially false and misleading statements. During the relevant period, Respondent, as an investment adviser representative of Merrill Lynch, misrepresented the process used to identify new money managers to the firm's advisory clients. Additionally, Respondent made materially misleading statements to at least one client relating to transition management services provided to

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1 The following related administrative proceedings were instituted today: In the Matter of Merrill Lynch, Pierce, Fenner & Smith Inc. and In the Matter of Jeffrey Swanson.

that client. Respondent thereby aided and abetted and caused Merrill Lynch's violations of Section 206 of the Advisers Act.

8. Under Section 206 of the Advisers Act, an investment adviser has a fiduciary duty to disclose all material conflicts of interests to its advisory clients.[2] During the relevant time period, Respondent, as an investment adviser representative of Merrill Lynch, caused Merrill Lynch's violations of Section 206 of the Advisers Act by failing to ensure that material conflicts relating to the recommendation of directed brokerage and transition management were disclosed to the firm's advisory clients.

MATERIAL MISREPRESENTATIONS CONCERNING THE MANAGER IDENTIFICATION PROCESS

9. During the relevant period, Respondent misrepresented the process used to identify new money managers for clients in breach of his fiduciary duty to those clients. Respondent, in written communications, emphasized the extensive in-house resources and research that was available through Merrill Lynch to match each individual client with appropriate money managers for that client's needs. For example, in the summer of 2005, in response to heightened public scrutiny of the pension consulting industry, Merrill Lynch prepared responses to ten questions that the Commission and the Department of Labor jointly proposed in a press release dated June 1, 2005. In August 2005, a copy of those responses was mailed, under cover of Respondent's signature, to all of his Consulting Services clients along with their quarterly investment reports. That document states in part:

> When assisting Consulting Services clients in selecting investment managers, Merrill Lynch screens potential manager choices from a universe of over 1,000 investment managers .... [I]t is important to understand that these managers generally undergo a variety of screening processes, by, or under the direction of, a dedicated "home office" team solely responsible for such tasks. This team analyzes manager information derived from proprietary and non-proprietary sources to be able to offer a choice of managers best able to meet client needs and goals.

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2 SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 191-92 (1963) (The Advisers Act reflects "a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which is not disinterested."); In re O'Brien Partners, Inc., Advisers Act Release No. 1772 (Oct. 27, 1998) (" . . . since even potential conflicts of interest are material and must be disclosed, [the investment adviser] was required to disclose its receipt of third-party payments, even if it had concluded that the payments did not influence the manner in which it advised its clients."); In the Matter of Feeley & Willcox Asset Management Corp., Advisers Act Release No. 2143 (July 10, 2003) ("It is the client, not the adviser, who is entitled to make the determination whether to waive the adviser's conflict. Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate, much less waive, the conflict.").

10. Respondent explained the manager search process to clients in terms of Merrill Lynch's vast resources, and in a manner suggesting that the centralized nature of the process protected against conflicts of interest. He sent letters to several clients stating:

> All of our decisions regarding the recommendation of investment management firms are based on the in-depth quantitative and qualitative analysis provided by our 22 member manager research team headquartered in New Jersey. Our recommendations are unbiased and made only with our clients' best interest in mind.
>
> I choose to remain at Merrill Lynch after 28 years because . . . our manager research team provides us the tools and resources to deliver to you with confidence manager recommendations that are well researched, objective and devoid of inappropriate influence.

11. Contrary to written representations to clients and prospective clients, Respondent and others on his team recommended money managers whom he knew were not identified, vetted or approved by Merrill Lynch Consulting Services in New Jersey before they were first recommended to clients. Those money managers included several direct real estate managers, even though Respondent was aware that these managers had not, and would not be, identified, vetted or approved by Merrill Lynch Consulting Services in New Jersey.

12. Moreover, the Callaway Team's manager searches differed significantly from the way Respondent and his team described them to clients and prospective clients. Respondent and his team did not rely on the New Jersey office to analyze and recommend potential managers for his Consulting Services clients' specific needs. Rather, he and his team conducted the manager search process themselves using a short list (the "Callaway short list") of managers, which had been developed by the Callaway Team. This list consisted of approximately sixty money managers divided into ten or eleven categories of managers, each containing approximately six money managers, therefore potentially giving rise to a limited universe of recommendations. The list also contained money managers who had not been vetted by Merrill Lynch Consulting Services in New Jersey.

13. When one of the Callaway Team's Consulting Services clients requested a new manager search, an associate in the Callaway Team, working at the direction of Respondent or another investment adviser representative on the team, would refer to the pre-existing Callaway short list, seek input from Respondent and sometimes from Merrill Lynch Consulting Services in New Jersey, obtain information on the money managers on the list from publicly available databases, and compile this information into a booklet to be presented to the client. These search reports were not reviewed by Merrill Lynch Consulting Services. Rather, Respondent decided, sometimes with non-client-specific input from Merrill Lynch Consulting Services, which money managers from the Callaway short list to present to the clients.

14. Respondent also failed to disclose his use of the vacation homes of principals of another money management firm that was on the Callaway short list. Respondent recommended this manager despite concerns about poor performance that were raised by some of Respondent's Consulting Services clients. This money manager directed a large percentage of the Callaway Team's client trading to Merrill Lynch for which Merrill Lynch Consulting Services and the Callaway Team received production credits. Because material facts relating to Respondent's relationship with this money management firm were not disclosed, clients were unable to evaluate whether his recommendation of this money management firm was disinterested. Respondent knew, or was reckless in not knowing, that these facts should have been disclosed to Consulting Services clients.[3]

15. Furthermore, Respondent had relationships with other money managers that he recommended to Consulting Services clients. He had received production credits, purportedly for Merrill Lynch research, from two money managers whom he recommended to Consulting Services clients. Moreover, Respondent had an agreement with one of those money managers whereby the manager would direct a certain amount of brokerage in their mutual client accounts to Merrill Lynch for which the Callaway Team received production credits.

16. Based on the above, Respondent knowingly or recklessly made misrepresentations to Merrill Lynch Consulting Services clients.

FAILURE TO DISCLOSE CONFLICT OF INTEREST CONCERNING DIRECTED BROKERAGE

17. During the relevant period, Respondent failed to ensure that the conflicts of interest inherent in the recommendation of directed brokerage to Consulting Services clients was disclosed. Merrill Lynch Consulting Services and, consequently, Respondent had a financial incentive to recommend that Consulting Services clients enter into a directed brokerage relationship. Merrill Lynch Consulting Services charged for its pension consulting services on a fixed fee basis. Clients could pay in cash, referred to as "hard dollars," or through "directed brokerage."[4] Merrill Lynch Consulting Services and Respondent received a portion of these directed brokerage commissions and continued to receive them even after the Consulting Services fee was satisfied.

18. Respondent recommended that Consulting Services clients establish a directed brokerage relationship with Merrill Lynch's institutional trading desk as part of the process of

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[3] Production credits entitled Merrill Lynch Consulting Services, Respondent and the Callaway Team to share in the generated commissions.

[4] Directed brokerage is an arrangement whereby the clients directed money managers to execute trades through Merrill Lynch's institutional trading desk, consistent with their best execution obligations. In return, these clients received credit for a portion of the commissions generated by these trades against the hard dollar fee owed to Merrill Lynch Consulting Services.

establishing new accounts on behalf of those clients. The majority of the Callaway Team Consulting Services clients had such relationships.

19. Merrill Lynch Consulting Services and, consequently, Respondent often received significantly more fees from the directed brokerage commissions generated from trading activity in the Callaway Team's Consulting Services client accounts than the fees they would have received if those clients had paid strictly with hard dollars because money managers continued to direct brokerage to Merrill Lynch even after their client's Consulting Services hard dollar fee was satisfied. For example, in one instance a Callaway Team client who was obligated to pay a $7,500 annual hard dollar fee generated almost $175,000 in production credits.[5] Other examples include a Callaway Team Consulting Services client generating over $100,000 in production credits when its hard dollar fee was $15,000; and another Callaway Team Consulting Services client generating production credits of $145,000 with a hard dollar fee of $32,000.

20. Some of the Callaway Team Consulting Services clients, many of whom were not knowledgeable about their trading options, did not appreciate the extent to which Merrill Lynch Consulting Services and, consequently, Respondent stood to gain additional fees from a client's directed brokerage relationship with Merrill Lynch. For example, in 2005, one client agreed to increase its hard dollar fee from $15,000 to $20,000 because the client believed that Respondent was "getting almost nothing" and it needed to do something to make sure that he was compensated for his services. In fact, in 2004 this client generated revenues of $103,000 to Merrill Lynch Consulting Services, of which the Callaway Team was credited with approximately $46,000. Likewise, the chairman for another Callaway Team Consulting Services client stated that he would be "shocked" to learn that the fund generated fees in excess of $100,000 in 2004. That year, this particular client's hard dollar fee was $45,000; the fund generated production credits to Merrill Lynch Consulting Services of $118,000. The Callaway Team Consulting Services clients who established a directed brokerage relationship with Merrill Lynch were unable to assess all of Merrill Lynch Consulting Services', and, consequently, Respondent's motivations in recommending the use of directed brokerage to pay for services and therefore were unable to assess the recommendation.

21. Based on the above, Respondent, at a minimum, negligently failed to ensure that the conflicts of interest inherent in the recommendation of directed brokerage were disclosed to the Consulting Services clients he served.

[5] This client's offset rate was .5 therefore $15,000 of production credits was required to offset its hard dollar fee of $7,500. Hence, roughly $160,000 of production credits was generated to Merrill Lynch Consulting Services above the hard dollar fee.

FAILURE TO DISCLOSE CONFLICT OF INTEREST AND MATERIALLY MISLEADING STATEMENTS CONCERNING TRANSITION MANAGEMENT

22. During the relevant period, Respondent recommended to certain Consulting Services clients that they use Merrill Lynch for transition management. Transition management is a service offered by Merrill Lynch's transition management group, a separate unit from Merrill Lynch Consulting Services, to clients in the process of terminating one money manager and hiring another.[6]

23. Respondent and other members of the Callaway Team recommended Merrill Lynch transition management services numerous times to Consulting Services clients. Between July 2000 and the end of 2005, at least nine Callaway Team Consulting Services clients used Merrill Lynch for transition management services on approximately 19 separate occasions generating over $735,000 worth of production credits to Merrill Lynch Consulting Services, of which the Callaway Team received approximately $330,000.

24. Respondent failed to disclose to Consulting Services clients that Merrill Lynch in its capacity as an adviser and, consequently, the Callaway Team had a financial incentive to recommend Merrill Lynch transition management. Merrill Lynch in its capacity as an adviser and, consequently, Respondent stood to make additional fees if the client chose to use Merrill Lynch transition management services inasmuch as Merrill Lynch Global Wealth Management and, consequently, the Callaway Team received a portion of the commissions generated in connection with transition management services provided by Merrill Lynch. Therefore, those clients were unable to evaluate whether the recommendation of Merrill Lynch's transition management services was disinterested.

25. Furthermore, in or about August 2003, Respondent made misleading statements to one Consulting Services client who raised questions about The Callaway Team's compensation as a result of transition management services provided to this client in 2002. In response to the client's inquiry about fees generated to the Callaway Team, Respondent provided a misleading response estimating his personal compensation to have been "impacted by some amount less than $3,000." In reality, the transition in question generated approximately $17,494 of production credits to the Callaway Team, an amount that was tracked, documented and easily identifiable by Callaway's associate. By responding narrowly to the client's inquiry, Respondent attempted to mislead the client into thinking the amount in question was *de minimis*.

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6 Without the services of a transition manager, the money manager being terminated would sell any shares held by the client that the new money manager did not want to keep and transfer the proceeds from those sales to the client's account. The new money manager would then use these proceeds to purchase securities for its portfolio on behalf of the client. Consequently, the process of terminating and hiring a new money manager results in the generation of commissions. Merrill Lynch's transition management desk represented that it could manage a transition more efficiently and cost-effectively by offering cross trades and reduced commission costs.

26. However, the client was not satisfied with his response and pressed for additional information on the fees generated including whether Merrill Lynch Consulting Services[7] receives any portion of commissions generated through transition management services. Callaway responded that, "the total dollar value of the credit received by Merrill Lynch Consulting Services for the transition management services provided last year was $17,494." Respondent's answer was again misleading. The transition actually generated production credits of approximately $38,877 to Merrill Lynch Global Wealth Management Group of which approximately 45% or $17,494 of production credits went to the Callaway Team. Again, Respondent attempted to mislead the client into thinking that the transition had a minimal impact on the Callaway Team's compensation. Ultimately, this client demanded, and received, a credit from Respondent for a portion of the production credits that were generated to the Callaway Team as a result of its use of Merrill Lynch's transition management services.

27. Respondent's recommendation of transition management services to Consulting Services clients benefited Merrill Lynch in its capacity as an adviser and, consequently, Respondent and the Callaway Team in a direct and calculable way. Because he did not disclose this fact to Consulting Services clients they were unable to evaluate whether the recommendation of Merrill Lynch's transition management services was disinterested. Consequently Respondent, at a minimum, negligently failed to ensure that the conflict of interest inherent in the recommendation of transition management services were disclosed to the Consulting Services clients he served. Moreover, Respondent provided misleading information to one Consulting Services client who raised questions about his failure to disclose the fact that the Callaway Team received compensation in connection with its transition. Subsequent to this client's inquiry, Respondent continued to fail to disclose the fact that he and his team received a portion of the fees generated from transition management services to other clients he recommended use Merrill Lynch for transition management services. Respondent intentionally or recklessly made misrepresentations to his Consulting Services client about the fees he received in connection with transition management services.

28. In January 2007, Merrill Lynch implemented a policy prohibiting Merrill Lynch Consulting Services investment adviser representatives from recommending Merrill Lynch transition management services to their pension clients or from receiving production credits or other compensation resulting from trades in connection with transition management services that Merrill Lynch provides to their Merrill Lynch Consulting Services pension clients.

D. VIOLATIONS

29. As a result of the conduct described above, Respondent willfully aided and abetted and caused Merrill Lynch's violations of Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

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[7] The client and Callaway misunderstood which Merrill Lynch entity shared in the production credits for the advisory client referral. Global Wealth Management Group received the credits. Merrill Lynch Consulting Services is part of that business unit.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203(i) of the Advisers Act and disgorgement pursuant to Section 203(j) of the Advisers Act, and pursuant to Section 15(b)(6) of the Exchange Act; and

C. Whether, pursuant to Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 206(2) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Chairman Schapiro and Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59328 / January 30, 2009

Admin. Proc. File No. 3-12933

In the Matter of the Application of

SCOTT EPSTEIN

c/o George L. Mahr, II
Mahr and Mahr, LLC
80 Main Street
P.O. Box 534
Madison, NJ 07940

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDING

Unsuitable Recommendations

Former registered representative of member firm of registered securities association made unsuitable recommendations to customers. Held, association's findings of violation and the sanction it imposed are sustained.

APPEARANCES:

George L. Mahr II and George L. Mahr III, of Mahr and Mahr, LLC, for Scott Epstein.

Marc Menchel, Alan Lawhead, and Gary J. Dernelle, for FINRA.

Appeal filed: January 17, 2008
Last brief received: July 7, 2008 1/

I.

Scott Epstein, a former registered representative with Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch" or the "Firm"), a member of the Financial Industry Regulatory Authority, Inc. ("FINRA"), appeals from FINRA disciplinary action. 2/ FINRA found that Epstein made unsuitable mutual fund switch 3/ recommendations to customers in violation of NASD Rules 2310, 2110, and IM-2310-2. 4/ For these violations, FINRA barred Epstein from

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1/ On July 15, 2008, FINRA moved for leave to file a sur-reply to Epstein's reply brief. Commission Rule of Practice 450 states that "No briefs in addition to those specified in the briefing schedule order may be filed except with leave of the Commission." 17 C.F.R. § 201.450. The briefing schedule order does not contemplate the filing of a sur-reply and we have determined that the filing of FINRA's additional brief is unnecessary to our review of Epstein's appeal. Accordingly, we deny FINRA's motion.

2/ 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. Because the final disciplinary action on appeal here was taken after the consolidation, references to FINRA herein shall include references to NASD.

3/ A mutual fund switch involves one or more mutual fund redemption transactions coupled with one or more related mutual fund purchase transactions. See Laurie Jones Canady, 34 S.E.C. 65, 68 n.5 (1999) (citing Russell L. Irish, 42 S.E.C. 735, 737 n.5 (1965) (defining mutual fund switch), aff'd, 367 F.2d 637 (9th Cir. 1966)), petition denied, 230 F.3d 362 (D.C. Cir. 2000).

4/ NASD Rule 2310, sometimes referred to as the "suitability rule," requires that, in recommending the purchase, sale, or exchange of any security to a customer, a member must have reasonable grounds for believing that the recommendation is suitable for that customer based on the facts, if any, disclosed by the customer as to his other securities holdings and the customer's financial situation and needs. NASD Rule IM-2310-2 imposes on members and registered representatives the obligation of "fair dealing" in relationships with customers, and states that sales efforts must be undertaken within NASD's ethical standards. NASD Rule 2110 requires the observance of "high standards of commercial honor and just and equitable principles of trade." A violation of the

(continued...)

acting in any capacity with any member firm. 5/ We base our findings on an independent review of the record.

II.

A. Background

Epstein joined Merrill Lynch in August 2000 after graduating from college and was assigned to a Merrill Lynch "call center" in Hopewell, New Jersey, the Financial Advisory Center (the "FAC"). 6/ Epstein was a registered general securities representative whose official title was Investment Services Advisor ("ISA").

The FAC handled Merrill Lynch accounts with assets of $100,000 or less. Merrill Lynch transferred such accounts from its branch offices to the FAC. Whenever a customer called Merrill Lynch, the call would be routed to a randomly-selected and available ISA. ISAs also would make unsolicited telephone calls to customers whose accounts had been transferred to the FAC. Customer conversations routinely were recorded by the FAC.

ISAs were permitted to make securities recommendations regarding mutual funds but not individual stocks and bonds except when a customer requested such advice. In his investigative testimony to NASD, Epstein stated that, when speaking with a customer, whether on an inbound call or on an unsolicited basis, the ISAs had access to information via their desktop computers and other proprietary databases regarding when a customer had opened an account, the customer's age, marital status, income, total net assets, and the type of investments they held. However, Epstein's counsel stated in an affidavit filed with the Commission in this proceeding that the ISAs frequently experienced difficulties with "the FAC computer system," which "crashed constantly."

4/ (...continued)
NASD suitability rule is also a violation of NASD Rule 2110. See, e.g., Wendell D. Belden, 56 S.E.C. 496 (2003).

5/ FINRA also assessed costs. It declined to reach findings by its Hearing Panel that Epstein's recommendations also were accompanied by misrepresentations and omissions of material fact. These allegations, therefore, are not before us.

6/ On March 15, 2006, Merrill Lynch settled NASD allegations relating to sales practice abuses at the FAC, without admitting or denying those allegations, by agreeing to a censure and a $5 million fine, in addition to several undertakings. See NASD Fines Merrill Lynch $5 Million for Call Center Supervisory Failures, Sales Contest Violations, http://www.finra.org/Industry/Issues/Advertising/NewsReleases/2006/p115786 (last visited Dec. 3, 2008).

ISAs were divided into teams and were required to achieve certain levels of production. The FAC occasionally held sales contests with prizes for individual ISAs and teams based on their overall production. Although the ISAs were salaried employees, the Firm offered them substantial bonuses for increased production, which included mutual fund sales. For example, Epstein was paid a base salary of $35,000 plus variable compensation consisting, in part, of bonuses called "production credits" for certain transactions. 7/ Epstein's variable compensation for the period from October 1, 2001 through March 2, 2002, approximately the period at issue, totaled $26,443.

Epstein, as a Merrill Lynch employee, agreed to comply with Merrill Lynch's Compliance Outline Handbook (the "Handbook"). The Handbook required the representative to "discuss the investment objective, investment strategy and risks associated with investment in any recommended mutual fund" and "the advantages and disadvantages of the various available share classes," including "front-end [and] back-end" loads, the Contingent Deferred Sales Charge ("CDSC") peculiar to Class B and Class C shares, "the existence and effect of any on-going distribution and maintenance fees," and the "availability of no-cost or low cost shares." 8/ The

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7/ The variable compensation consisted of three components: production; client contact/new money; and "focus scores" based on communication and customer service skills. Epstein was paid a percentage of the production credit amounts that he earned, depending on the nature of the transactions that he effected. As part of his variable compensation, Epstein also earned specific dollar amounts for achieving certain production credit "hurdles."

8/ Generally, each mutual fund comprises several classes of shares that have different kinds of sales charges and operating expenses associated with them. See Rule 18f-3 under the Investment Company Act of 1940, 17 C.F.R. § 270.18f-3; Exemption for Open-End Management Investment Companies issuing Multiple Classes of Shares, 60 Fed. Reg. 11875, 11876 (Mar. 2, 1995). For example, the major cost associated with purchasing Class A shares is a sales charge known as a "front-end load." See, e.g., Raghavan Sathianathan, Securities Exchange Act Rel. No. 54722 (Nov. 8, 2006), 89 SEC Docket 774, 775 (barring respondent for making unsuitable mutual fund recommendations and for unauthorized trading), petition denied, No. 07-1002, slip op. (D.C. Cir. Dec. 2, 2008); Mutual Fund Regulation § 18:4.1 (Clifford E. Kirsch ed., 2d ed. 2005). This sales charge is paid when the shares are bought and it is deducted from the amount invested (effectively reducing the quantity of mutual fund shares purchased). By contrast, Class B shares have a back-end sales charge – the CDSC – but no front-end load. Sathianathan, 89 SEC Docket at 776; see generally Investment Company Act Rule 6c-10, 17 C.F.R. § 270.6c-10; Exemption for Certain Open-End Management Investment Companies to Impose Contingent Deferred Sales Loads, 60 Fed. Reg. 11887 (Mar. 2, 1995). The CDSC is collected from the investor when the mutual fund shares are sold rather than at the time of purchase. Sathianathan, 89 SEC Docket at 776. Typically, the CDSC is reduced for

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Handbook cautioned that a switch should not be recommended "unless it will result in a net investment advantage for the client, considering all financial and other factors, including sales charges and tax consequences."

Merrill Lynch also provided ISAs with a summary sheet or "script" describing mutual fund share classes and the fees and expenses associated with each, that were to be discussed with customers. The script contained additional information regarding which share class would make the "most sense" for different types of customers, depending on their investment time horizon, the amount they wished to invest, and their sensitivity to fees and expenses. ISAs were expected to inform customers that "[t]he share class that is right for you depends in large part on the period of time you intend to hold the shares and the amount of money you intend to invest."

B. Epstein's Mutual Fund Switch Recommendations

FINRA's findings of violation relate to Epstein's recommendations between October 2001 and February 2002 of various transactions for the accounts of twelve FAC customers, many of whom were elderly, retired, and/or unsophisticated. Several of them had limited understanding of the applicable fee structures and other attributes of the funds referenced in Epstein's recommendations. Except as discussed below, Epstein did not inquire about the customer's financial situation or investment objectives. Sidney D. Krasner, of S.D. Krasner and Associates, who was qualified as an expert for NASD by the Hearing Panel, testified that Epstein "failed to secure sufficient information from these clients in order to make the kind of recommendations he made." According to Krasner, Epstein had an obligation "to refresh the record as to the risk tolerances and the investment objectives of these people," and "in most cases, [Epstein] failed to do that."

1. Thomas Reed

In October 2001, Epstein made an unsolicited telephone call to the seventy-eight year old Reed to discuss his IRA account, which consisted primarily of mutual funds. During their four-and-a-half minute conversation, Epstein recommended that Reed switch mutual funds into

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8/ (...continued)
each year that an investor holds Class B shares, phasing out entirely after a certain number of years. Id. Class C shares also impose a CDSC, see Mutual Fund Regulation at § 18:4.1, but that charge is usually eliminated after those shares have been held for more than one year.

something "a little bit more stable for you . . . ." Epstein informed Reed that "it's not going to cost you . . . at all . . . to make the change." Reed acceded to the switch. 9/

On October 15, 2001, Epstein executed the following transactions in Reed's IRA account:

Sold $89,524 Merrill Lynch High Income Bond Fund Class B shares.
Bought $88,000 Alliance US Government Bond Fund Class B shares.

This switch resulted in a production credit to Epstein of $3,520.

Reed had owned the Merrill Lynch High Income Bond Fund Class B shares since 1993. They had an expense ratio of 1.29%, while the Alliance US Government Bond Fund Class B shares had an expense ratio of 2.80%.

Because the IRA had held the Merrill Lynch High Income Bond Fund Class B shares for more than four years, and the holding period for the back-end sales charge – the CDSC – for that investment had expired, Reed incurred no CDSC upon the sale of those shares. However, Epstein did not inform Reed that the Merrill Lynch High Income Bond Fund Class B shares would convert automatically into less expensive Class D shares of that fund with an expense ratio of 0.77% within two years (i.e., ten years after the original date of purchase). 10/ By switching the Merrill Lynch Class B shares out of that mutual fund less than two years before they were due to convert into less costly Class D shares, Epstein interrupted the holding period and eliminated the availability of a lower expense ratio for Reed's investment. Epstein also did not inform Reed that switching to the Alliance US Government Bond Fund Class B shares would trigger a new three-year CDSC holding period and higher operating expenses than the Merrill

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9/ Reed's side of the recorded conversation can be heard clearly, while portions of Epstein's remarks are inaudible. Nonetheless, it is clear from both the transcript and the recording of the conversation that Epstein recommended that Reed switch mutual funds.

10/ The expense ratio for Class B (or Class C) shares typically is larger than for Class A shares. See generally Mutual Fund Regulation at § 18:4.1. According to NASD expert witness Krasner, Class B shares typically convert to either Class A shares with lower operating costs or to another share class with lower operating costs, usually after six to ten years. See also Investment Company Act Rule 18f-3(f), 17 C.F.R. § 270.18f-3(f); Exemption for Open-End Management Investment Companies issuing Multiple Classes of Shares, 60 Fed. Reg. at 11878. For example, according to Krasner, many Merrill Lynch Class B shares convert to Class D shares that have lower operating expenses than Class B shares but higher operating expenses than Class A shares. In other fund families, Class B shares eventually convert to Class A shares. See Sathianathan, 89 SEC Docket at 776.

Lynch High Income Bond Fund Class B shares. 11/ Epstein further did not tell Reed he could switch from the Merrill Lynch High Income Bond Fund Class B shares to the Merrill Lynch U.S. Government Fund Class B shares, with an expense ratio of 1.52%, without triggering a new CDSC holding period. Moreover, the Merrill Lynch U.S. Government Fund Class B shares would have matured into Class D shares, with an expense ratio of 1.00%, in less than two years because the investment would have maintained its original 1993 Merrill Lynch purchase date.

NASD expert Krasner observed that "[n]one of the inherent costs (or lost benefits) were discussed with Mr. Reed." Krasner testified that, although this switch was out of a "junk-bond fund" into a "more conservative" investment, Epstein failed to alert Reed that "the alternative for this switch was to buy the Merrill Lynch United States Government fund" which "would have been cost free, because the switch would have been within the same family of funds."

An NASD compliance specialist testified at the hearing that Epstein would not have received any production credit for recommending an exchange within the same mutual fund family. She also testified that, based on her review of Epstein's conversations with the customers, there were "no instances" where Epstein offered or discussed with customers the possibility of a free exchange of a mutual fund they already owned to another fund within the same fund family.

2. Doris Baumann

In October 2001, Epstein made an unsolicited telephone call to the residence of Doris Baumann, then an eighty-one year old homemaker, to discuss her Merrill Lynch trust account, of which she was the trustee. Baumann held a combination of mutual funds and individual stocks in that account. Epstein did not reach Baumann, but instead spoke to an individual who identified himself as Baumann's husband ("R. Baumann").

During their seven-and-a-half minute conversation, Epstein recommended to R. Baumann that Baumann switch from the Putnam New York Tax Exempt Fund, whose yield had fallen, to an Alliance fund that, Epstein stated, would provide Baumann with a better tax-free yield. Epstein assured R. Baumann that the switch to the Alliance fund "wouldn't incur any sort of

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11/ Generally, according to Krasner, investors who switch funds within the same fund family can "tack" their holding period from the old fund to the new fund within that fund family. For example, if an investor who holds a class of shares with a CDSC that phases out after five years switched to another fund within the same fund family after two years, those two years would be credited toward the total five year period to which the CDSC would apply. Thus, the investor's original purchase date would be deemed the starting point for the calculation of any CDSC holding period for any fund within the same fund family. By contrast, according to Krasner, there usually is no tacking for switches between funds in different fund families. Switching between funds from different fund families would restart the holding period.

upfront sales charge" and that "there would just be a one-year hold on the investment." Epstein also informed him that "if you sold it in the first year, there'd be a 1 percent charge," but if "you hold onto it longer than that, no charge at all." At one point during the conversation, R. Baumann seemed confused, stating "[L]et me make – make sure. Let me – let me clear that up in my own mind." Eventually, R. Baumann acceded to Epstein's recommendation.

On October 18, 2001, Epstein executed the following transactions in Baumann's trust account:

Sold $93,892 Putnam New York Tax Exempt Income Class A shares.
Bought $93,000 Alliance Municipal Income Fund NY Class C shares.

This switch resulted in a production credit to Epstein of $3,720.

The Putnam New York Tax Exempt Income Class A shares had an expense ratio of 0.82%, while the Alliance Municipal Income Fund NY Class C shares had an expense ratio of 1.47%. R. Baumann stated in his declaration to NASD that he "did not understand the difference in expenses between the different classes of shares and Scott Epstein never explained it to [him]." 12/

In analyzing these transactions, Krasner questioned the suitability of Epstein's recommendation. Krasner noted that, although the performance of the two funds was "almost identical" over a five year period, the "total return for year 2000 was more than 200 basis points better for the Putnam Fund than for the Alliance Fund." According to Krasner, Epstein recommended a switch "from a Class A mutual fund, which already had reduced operating costs, into a Class C mutual fund that had substantially higher operating costs," and "those operating costs were never going to go away." Krasner also noted that "Epstein never explained . . . that there would be ongoing and continuing operating costs."

Epstein did not inquire as to Baumann's financial or tax status or other circumstances. As a result of the switch, Baumann realized a capital gain of $8,000 and incurred a corresponding tax liability of approximately $1,200. In his declaration to NASD, R. Baumann stated that "[a]t

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12/ Class B and Class C shares typically carry higher distribution-and-service fees ("12b-1 fees") than Class A shares. See generally Mutual Fund Regulation at § 18:4.1. Accordingly, the total annual fund operating expense ratios for Class B and Class C shares generally are higher than those for Class A shares. See, e.g., Sathianathan, 89 SEC Docket at 776. The 12b-1 fees on Class B and Class C shares function as an ongoing sales charge for those shares and are deducted from the fund's assets. Class B shares typically convert to Class A shares (or to another class with lower 12b-1 fees) some time after the Class B shares' CDSC holding period has phased out. However, according to Krasner, Class C shares typically do not convert to another class of shares and thus continue to shoulder higher 12b-1 fees.

the time that [he] agreed to sell the Putnam, [he] never considered the tax consequences that [he] would be hit with." According to R. Baumann, "Epstein never discussed this with [him]" and if he had known, he would not have agreed to the switch.

3. Rose Roberts

In October 2001, Roberts, then a seventy-five year old widow, telephoned the FAC to inquire about the available balance in her money market account and to withdraw $300 from that account. As Roberts later stated in her declaration to NASD, she "had no intentions at the time to buy or sell anything."

Roberts's call was routed to Epstein. During the approximately twenty minute conversation, Epstein, after determining that Roberts was "looking to generate mainly income," and despite her apparent reluctance, recommended that Roberts liquidate her existing Eaton Vance Virginia Municipal fund and switch to another mutual fund that would provide her with a "higher tax free yield." Epstein also recommended "moving the money" from her IRA money market account "into some government bonds in something that is going to provide you with a higher yield." Although Roberts told Epstein "You're going too fast for me" and "I think I'm lost here (laughing)," she eventually acceded to Epstein's recommendations. Epstein never mentioned the name of the fund into which he planned to switch Roberts and did not discuss fees and expenses.

On October 31, 2001, Epstein executed the following transactions in Roberts's trust account:

Sold $21,615 Eaton Vance Virginia Municipal Fund Class B shares.
Bought $21,000 Alliance Muni Income Fund II, Virginia Portfolio, Class B shares.
Redeemed $9,385 from the money market account.
Bought $10,000 Merrill Lynch Municipal Bond National Fund Class B shares.

Epstein received production credits of $840 and $400, respectively, for these transactions.

The Eaton Vance Virginia shares had a slightly higher expense ratio than the Alliance Muni Income Fund shares. However, Roberts was beyond the CDSC holding period in her Eaton Vance fund. Had Roberts remained invested in the Eaton Vance Virginia Municipal Fund Class B shares, they would have matured into Class A shares with an expense ratio of 0.87%. 13/ Instead, when Epstein switched Roberts from that fund into Alliance Class B shares, which was in a different fund family, it triggered a new six-year CDSC holding period with a higher expense

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13/ The record does not indicate when the Eaton Vance Virginia Municipal Fund Class B shares would mature into Class A shares.

ratio than Roberts would have incurred had she maintained her Eaton Vance investment and the Class B shares matured into Class A shares. 14/

Epstein also executed the following transactions in Roberts's IRA account:

Redeemed $12,000 from the money market account within the IRA.
Bought $12,000 Merrill Lynch Core Bond Fund Class B shares.

Epstein received a production credit of $480 for this transaction.

Krasner noted that Epstein recommended that Roberts redeem some of her money market funds to buy government bonds. However, Epstein bought Merrill Lynch Core Bond Fund Class B shares instead. Krasner stated that Epstein never discussed the costs associated with that purchase nor provided Roberts with relevant information regarding the mutual fund. When Roberts received confirmation of these transactions, she became upset and, as she stated in a complaint letter to Merrill Lynch, contacted the FAC "many times during November-December 2001" attempting to reach Epstein, who "never returned any of [her] calls."

4. Vernan Brisson

In October 2001, Epstein made an unsolicited telephone call to the Brisson residence to discuss a joint Merrill Lynch account held by Vernan Brisson, his wife, and a third individual who was in her nineties. During their ten minute conversation, Epstein, without gathering any information from Vernan Brisson, almost immediately prodded Brisson into considering a mutual fund switch, stating that he would like to see some of Brisson's holdings "reinvested elsewhere" for "stability" of principal. Among other things, Epstein recommended switching to a "PIMCO bond fund," which he acknowledged was in "a different fund family," but emphasized its stability. Epstein recommended taking half of each of Brisson's mutual funds – a Franklin, a Lord Abbett, and two Merrill Lynch funds – and allocating them to "government issue bonds." Epstein stated that "there wouldn't be any sort of a front-end sales charge" for switching into the PIMCO Real Return Bond fund. Without discussing the different share classes, Epstein stated that "you pay the upfront sales charge to . . . get the best return" and that the "other two options" involved one-year and six-year holding periods, respectively. Brisson subsequently agreed to Epstein's recommendations.

14/ Class B shareholders pay their sales charge by either redeeming their shares during the CDSC holding period, thus incurring the back-end load, or by paying 12b-1 fees for the duration of the CDSC holding period until the Class B shares mature into Class A (or Class D) shares with a lower expense ratio. See Sathianathan, 89 SEC Docket at 776. According to Krasner, a long-term Class B shareholder who switches to Class B shares of another fund in a different fund family does not receive the benefit of tacking and must restart the entire process of paying the CDSC over a new holding period.

On October 25, 2001, Epstein executed the following transactions in the Brisson joint account:

Sold $18,000 Franklin Income Fund Class A shares.
Sold $11,724 Lord Abbett Bond Debenture Fund Class B shares.
Bought $5,000 Merrill Lynch Core Bond Fund Class B shares.
Bought $25,000 PIMCO Real Return Fund Class C shares.

Epstein received a production credit of $1,000 for the switch to the PIMCO Real Return Fund and $200 for the switch to the Merrill Lynch Core Bond Fund.

The Franklin Income Fund Class A shares had an expense ratio of 0.76%, while the Merrill Lynch Core Bond Fund Class B shares had an expense ratio of 1.34%. The switch to Class B shares in a different fund family triggered a new CDSC holding period. Epstein failed to explain that the $5,000 added to the Brisson joint account's existing Merrill Lynch Core Bond Fund Class B position had its own new CDSC holding period, even though one of the account holders was in her nineties. 15/

The Lord Abbett Bond Debenture Fund Class B shares had an expense ratio of 1.62%, while the PIMCO Real Return Fund Class C shares had an expense ratio of 1.44%. Despite the slightly lower expense ratio of the latter fund, Epstein did not explain that the PIMCO Funds Class C shares did not convert into other share classes, while the liquidated Lord Abbett Class B shares, which Brisson purchased originally in 1996, would have converted automatically to lower cost Class A shares within three years. Thus, following this conversion, Brisson would pay higher fees for as long as the account held the PIMCO fund.

5. Gloria Ann Johannsen-Johnson

In late October 2001, Johannsen-Johnson, then a fifty-eight year old widow, contacted the FAC to withdraw $30,000. Johannsen-Johnson held two separate accounts at Merrill Lynch – a regular investment account and a retirement account consisting of her IRA. Her call was routed to Epstein.

During their ten minute conversation, Epstein determined that, because Johannsen-Johnson's regular investment account had a balance of only $2,000 (which she did not want to liquidate) the $30,000 would have to come from her IRA account. Johannsen-Johnson stated that

15/ Because Class A shareholders pay their sales charge upfront, in the form of a front-end load, switching from Class A shares to Class B or Class C shares results in new sales charges for the investor. According to Krasner, switching a Class A shareholder or long-term Class B shareholder to Class C shares of a fund in a different fund family triggers a new CDSC holding period without the possibility of conversion to a less expensive class of shares over time.

she was willing to incur the ten percent early withdrawal penalty for deducting funds from her IRA.

Observing that her IRA consisted of individual stocks and a couple of mutual funds, Epstein told Johannsen-Johnson, "the two funds you have in there really haven't been very good over the last couple of years." When Johannsen-Johnson concurred, Epstein stated, "You know, we definitely recommend reallocating there." Epstein then recommended selling some of her holdings and "then take whatever's left . . . and get that reallocated into a couple – a couple of different funds for you, maybe a growth fund and a value fund." Epstein did not identify those funds, nor did he discuss the costs associated with switching to those funds.

In late October and early November 2001, Epstein executed the following transactions in Johannsen-Johnson's IRA account:

Sold $35,693 Elan Corp. PLC stock.
Sold $8,619 Alliance Technology Fund Class B shares.
Sold $20,750 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $10,000 Oppenheimer Quest Balanced Fund Class B shares.
Bought $9,999 PIMCO Renaissance Fund Class B shares. 16/

Epstein received a production credit of $400 for the switch to the Oppenheimer fund and a production credit of $400 for the switch to the PIMCO fund.

The switch from the Merrill Lynch Balanced Capital Fund Class B shares, which had an expense ratio of 1.61%, to the Oppenheimer Quest Balanced Fund Class B shares, which had an expense ratio of 2.06%, was a switch between two funds with similar investment goals from different fund families. Epstein never informed Johannsen-Johnson that her Merrill Lynch Class B shares, which she purchased in 1996, would have matured into Class D shares, with an expense ratio of 0.84%, in another two-and-a-half years (i.e., eight years after the original purchase date). Epstein also did not inform Johannsen-Johnson that the switch from the Merrill Lynch to the Oppenheimer fund would trigger a new CDSC holding period and increased operating expenses. In her declaration to NASD, Johannsen-Johnson stated that "Epstein never mentioned anything about any charges or fees that would have been associated with buying new mutual funds." Moreover, Epstein "never told [her] about different classes of mutual funds, expenses, or contingent deferred sales charges."

Krasner observed that a "more cost effective switch" would have been into another Merrill Lynch mutual fund (which would have enabled tacking of the holding period of the Merrill Lynch Balanced Capital Fund Class B shares), several of which were comparable to the Oppenheimer or PIMCO funds. Beyond discussing the penalty for early withdrawal from her

16/ The remainder of the funds from the sales apparently were withdrawn or used to pay the early withdrawal penalty.

IRA account, Epstein did not inquire as to Johannsen-Johnson's financial or tax status or other circumstances, or otherwise seek to obtain information from her that would have helped Epstein determine whether his recommendation was suitable.

6. Helen Martindale

In November 2001, Epstein made an unsolicited telephone call to Martindale, who held a combination of mutual funds and individual stocks in her Merrill Lynch account. The record does not include Martindale's age or other personal information about her.

During their nine minute conversation, Epstein recommended switching mutual funds at the outset, suggesting that Martindale sell her existing Franklin Federal Tax Exempt Fund shares and "move it over and add that" to her existing Nuveen Colorado Municipal Bond Fund holdings. Epstein then had an abbreviated discussion of share classes and sales charges without identifying either the share classes or the sales charges associated with the mutual funds that he was recommending. Epstein informed Martindale that she would have to hold the Nuveen fund for one year and that there would not be "any costs associated with it" but there would be a "higher yield." Martindale acceded to Epstein's recommendation.

On November 1, 2001, Epstein executed the following transactions in Martindale's account:

Sold $47,296 Franklin Federal Tax Free Fund Class A shares.
Bought $47,000 Nuveen Colorado Municipal Bond Fund Class C shares.

Epstein received a production credit of $1,880 for this switch.

Although Epstein told Martindale that there would be no cost associated with the purchase of Nuveen Colorado Muni Bond Fund Class C, in fact those Class C shares had a higher expense ratio than the Franklin Federal Tax Free Fund Class A shares. The Franklin Federal Tax Free Fund Class A shares had an expense ratio of 0.60%, while the Nuveen Colorado Municipal Bond Fund Class C shares had an expense ratio of 1.55%. Moreover, the Nuveen Class C shares do not convert to Class A, which caused Martindale to incur higher operating expenses for the duration of her ownership of those shares over expenses charged on Franklin Federal Tax Free Fund Class A shares. Epstein also did not inform Martindale about the possibility of switching to the Franklin Colorado Tax Free Income Fund, which would have avoided the Nuveen Class C shares' one-year, one percent CDSC. Martindale was eligible for a "free exchange" from the Franklin Federal Tax Free Fund to the Franklin Colorado Tax Free Income Fund Class A shares, which had an expense ratio of 0.71%.

7. Stuart Angevine

In November 2001, Epstein made an unsolicited telephone call to Angevine, then a seventy-five year old retired FBI agent. During their thirteen minute conversation, Epstein recommended that Angevine switch from his Merrill Lynch Balanced Capital Fund to "a different balance fund" that would be "a little bit better. It's got a better track record and should hopefully continue to perform a little better." Epstein did not disclose the name of the fund that he recommended to Angevine.

On November 6, 2001 Epstein executed the following transactions in Angevine's account:

Sold $39,738 Merrill Lynch Balanced Capital Fund Class D shares. 17/
Bought $38,000 Oppenheimer Quest Balance Fund Class C shares.

Epstein received a production credit of $1,520 for the switch.

The Merrill Lynch Balanced Capital Fund Class D shares had an expense ratio of 0.84%, while the Oppenheimer Quest Balance Fund Class C shares had an expense ratio of 2.06%. These were two very similar mutual funds, but the switch resulted in substantially higher operating expenses to Angevine. Epstein also did not explain that the Oppenheimer Class C shares would not convert into shares with a lesser expense ratio.

8. Wayne Ford

In January 2002, Epstein made an unsolicited telephone call to Wayne Ford to discuss one of the mutual funds in Ford's account. During their two-and-a-half minute conversation, Ford explained to Epstein that, even though he was named on the Merrill Lynch account, it was "really [his] mom's account." Epstein recommended switching out of that fund into some "higher yielding bonds" that would continue "to provide her with monthly checks."

On January 8, 2002, Epstein executed the following transactions in Ford's account:

Sold $44,863 Alliance Americas Government Income Fund Class A shares.
Bought $22,000 Merrill Lynch High Income Fund Class B shares.
Bought $22,000 Merrill Lynch U.S. Government Mortgage Fund Class B shares.

Epstein received a production credit of $880 for the switch to the Merrill Lynch High Income Fund Class B shares, which had an expense ratio of 1.29% and a CDSC holding period, and a

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17/ The spreadsheet that NASD introduced into evidence at the hearing misidentified these shares as Class A shares.

production credit of $880 for the switch to the Merrill Lynch U.S. Government Mortgage Fund Class B shares, which had an expense ratio of 1.52% and a CDSC holding period.

The Alliance Americas Government Income Fund Class A shares had a higher expense ratio of 2.26%. However, Epstein failed to recommend another Alliance Class A mutual fund. For example, Epstein could have switched to the Alliance High Yield Class A shares, with an expense ratio of 1.34%, or the Alliance U.S. Government Class A shares, with an expense ratio of 2.11%, within the same fund family as Ford's Alliance Americas Government Income Fund, but with lower expenses. Despite their higher expense ratio, had Ford remained invested in the Alliance Americas Government Income Fund Class A shares, he would have avoided CDSC holding periods.

9. Robert Gorman

In January 2002, Epstein made an unsolicited telephone call to Gorman, then a seventy-one year old retiree. During their five-and-a-half minute conversation, Epstein recommended switching from Gorman's existing balanced fund into a government bond fund and the Oppenheimer "quest for balance" fund, which had a "nice track record" and "would do a little bit better . . . ." Epstein did not discuss the operating costs and share classes of the funds to which he intended to switch Gorman or their impact on potential investment returns. Gorman acceded to Epstein's recommendation. 18/

On January 10, 2002, Epstein executed the following transactions in Gorman's account:

Sold $43,336 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $25,000 Franklin U.S. Government Securities Fund Class B shares.
Bought $28,000 Oppenheimer Quest Balanced Value Fund Class B shares.

Epstein received a production credit of $1,000 for the switch to the Franklin U.S. Government Securities Fund and a production credit of $1,120 for the switch to the Oppenheimer Quest Balanced Value Fund. The Franklin fund had an expense ratio of 1.25%, and the Oppenheimer fund had an expense ratio of 2.06%. The Merrill Lynch Balanced Capital Fund Class B shares had an expense ratio of 1.61%, but were to mature into Class D shares with an expense ratio of 0.84% within three weeks of the switch transaction. Instead of leaving that mutual fund undisturbed, Epstein switched the Merrill Lynch Balanced Capital Fund into other Class B shares of two different fund families, triggering new CDSC holding periods and higher expense ratios than the Class D shares.

18/ Although Epstein's side of the conversation is occasionally inaudible, it is clear from both the transcript and the recording of the conversation that Epstein recommended that Gorman switch mutual funds.

10. Victoria Wilson

In February 2002, Wilson, a retired widow, contacted the FAC to transfer her holdings from another brokerage firm into her existing Merrill Lynch account. Her call was routed to Epstein. During their six-and-a-half minute conversation, Epstein observed that she had held her Merrill Lynch Balanced Capital Fund "for a while" and recommended that she switch "into a different balance fund" that had "a little bit better track record and a little bit better management in place." In recommending an Oppenheimer fund, Epstein said that "we can do it at no cost to you and, you know, move it into a Class C share class where you don't pay anything upfront" and indicated that "there's only a one-year hold on the investment[.]" Wilson acceded to Epstein's recommendation.

On February 20, 2002, Epstein executed the following transactions in Wilson's Merrill Lynch account:

Sold $27,167 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $26,499 Oppenheimer Quest Balance Fund Class C shares.

Epstein received a production credit of $1,059 for the switch.

The Merrill Lynch Balanced Capital Fund Class B shares had an expense ratio of 1.61%, while the Oppenheimer Quest Balance Fund Class C shares had an expense ratio of 2.06%. These two mutual funds had similar portfolios and investment objectives.

Moreover, the Merrill Lynch Balanced Capital Fund Class B shares, which Wilson had purchased in 1996, would have converted to Class D shares, which had an expense ratio of 0.84%, in approximately two years. Epstein failed to explain these expense differences, which he was obligated to do, or take into account that the CDSC holding period for Wilson's investment in the Merrill Lynch Balanced Capital Fund Class B shares had already expired.

11. Dorothy Paige

In February 2002, Paige, then a seventy-six year old widow, contacted the FAC to request that a service charge be removed from three accounts held for the benefit of her great grandchildren. Her call was routed to Epstein. During their ten minute conversation, Epstein expressed dissatisfaction with the performance of her investments and recommended that she switch to different mutual funds. Epstein stated, "What I'd like to do is move it into a different fund going with an – with an Oppenheimer Balance Fund, but a fund that's – that's done a little bit better" Epstein informed Paige that "it's not going to cost us anything to make the changes." Paige acceded to his recommendation.

On February 6, 2002, Epstein executed the following transactions in each of the three accounts that Paige held for the benefit of her great grandchildren:

Sold $10,593, $10,720, and $10,720 Merrill Lynch Balanced Capital Fund Class B shares.
Bought $10,593, $10,720, and $10,720 Oppenheimer Quest Balanced Value Capital Fund Class B shares.

Epstein received production credits totaling nearly $1,300 for the three switches.

The Merrill Lynch Balanced Capital Fund Class B shares had an expense ratio of 1.61%. The Merrill Lynch shares, which Paige purchased in 1997, would have matured into D shares, with an expense ratio of 0.84%, in another three years. Paige's Merrill Lynch Balanced Capital Fund Class B CDSC period was nearly at an end. In contrast, the Oppenheimer Quest Balanced Value Capital Fund Class B shares had an expense ratio of 2.06%, and the switch triggered a new six-year CDSC holding period.

Epstein failed to explain that the existing fund had a lower expense ratio than the one he recommended, or that, in three years, the operating expenses of Paige's existing fund would be reduced further. Epstein also failed to suggest a cost-free exchange into another Merrill Lynch fund.

12. Kenneth Wilson 19/

In January 2002, Epstein made an unsolicited telephone call to Wilson, who was seventy-four years old. During their nine minute conversation, Epstein expressed concerns about Argentina's political and economic situation in connection with Wilson's existing holdings in the Alliance Americas Government Income Fund. Epstein then recommended that Wilson switch to a "high yield fund" and a "government mortgage fund."

On January 8, 2002, Epstein executed the following transactions in Wilson's account:

Sold $21,842 Alliance Americas Government Income Fund Class A shares.
Bought $20,000 Merrill Lynch NJ Muni Bond Fund Class C shares.

Epstein received a production credit of $800 for this switch.

The Alliance Americas Government Income Fund Class A shares had an expense ratio of 2.26%, while the Merrill Lynch NJ Muni Bond Fund Class C shares had an expense ratio of 1.40%. However, as an alternative, Wilson could have switched from the Alliance Americas Government Income Fund Class A shares to the Alliance NJ Muni Fund Class A shares, with an expense ratio of just 0.85%.

19/ The record contains a recording of Wilson's conversation with Epstein but no transcript of that conversation.

C. Proceedings Below

Around August 30, 2002, Rose Roberts wrote to NASD to complain about Epstein's handling of her account. 20/ Following receipt of the Roberts letter, NASD began an investigation of Epstein and questioned him about his recommendations. 21/

On July 11 and 12, 2005, FINRA held a disciplinary hearing in this matter. Epstein was listed as a potential witness on the witness list submitted by FINRA's Department of Enforcement (the "DOE"). However, Epstein did not testify or appear at the disciplinary hearing, 22/ and Epstein's counsel left the hearing before introducing any evidence or presenting a defense. FINRA based its findings on recordings of the telephone conversations that Epstein had with the customers involved, transcripts of those recordings, customer declarations, complaint letters, and testimony from FINRA staff and Krasner.

III.

Epstein does not challenge directly FINRA's findings that he made unsuitable mutual fund switch recommendations in violation of NASD Rules 2310, 2110, and IM-2310-2, and we find that the evidence amply supports those findings. Epstein does, however, complain about the evidence introduced at the hearing.

A. NASD Conduct Rule 2310(a) 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

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20/ In that letter, Roberts stated that, during her telephone conversation with Epstein, he "started to talk about this and that" and she "let it go" even though she "had no intention of buying or selling anything" at the time. The letter also detailed her unsuccessful attempts to contact Epstein at the FAC after she had received written confirmation of the transactions that he had effected in her accounts. In particular, Roberts asserted in her letter that she "had owned the Eaton Vance Fund for over 18 years and had no intentions of selling it, especially for something [she] had never heard of like Alliance."

21/ Epstein has not worked in the securities industry since Merrill Lynch terminated his employment on November 15, 2002 as part of a "reduction in staff."

22/ Epstein's counsel explained Epstein's absence by stating that "he is not here today because he is working."

such customer as to his other security holdings and as to his financial situation and needs." 23/ NASD Rule IM-2310-2(a)(1) imposes on members and registered representatives the "fundamental responsibility for fair dealing," which is "[i]mplicit in all [their] relationships" with customers. As relevant here, NASD Rule IM-2310-2(a)(2) provides that "sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed . . . ." In applying the suitability rule to mutual fund transactions, we have held that a "recommendation is not suitable merely because the customer acquiesces in the recommendation. Rather, the recommendation must be consistent with the customer's financial situation and needs." 24/

NASD Notice 95-80 states further that a registered representative "must not recommend that a customer switch from one mutual fund to another based on the compensation" that the registered representative "will receive for effecting the switch." 25/ The Handbook, to which Epstein twice signed attestations, contained a section advising registered representatives to have a reasonable basis for believing that recommendations to clients, particularly elderly clients, were suitable.

Epstein's mutual fund switch recommendations subjected the customers to higher expenses, longer holding periods, or denied them lower operating expenses to which they would have been entitled with the passage of time. Epstein frequently recommended that a customer switch from a less expensive mutual fund to one with a higher expense ratio. Epstein also failed to recommend cheaper mutual fund alternatives within the same fund family, which would have avoided triggering new CDSC holding periods for Class B shares. In addition, Epstein frequently failed to disclose that a switch between mutual funds with similar investment objectives and strategies would result in higher expenses that would reduce potential investment returns. Epstein did not tell the customers that several of his mutual fund switch recommendations triggered new CDSC holding periods. In some instances, when recommending a switch to a mutual fund with a one-year holding period, Epstein did not disclose to customers that, while the CDSC charge would disappear after one year, the higher operating costs associated with the recommended Class C shares would continue indefinitely. Epstein also did not inform several customers that, if they held onto their existing investment in Class B shares, those shares would

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23/ See Sathianathan, 89 SEC Docket at 782; Maximo Justo Guevara, 54 S.E.C. 655, 662 (2000) (applying suitability rule), petition denied, 47 Fed Appx. 198 (3d Cir. 2002) (Table); Rafael Pinchas, 54 S.E.C. 331, 341 (1999) (same).

24/ Dane S. Faber, 57 S.E.C. 297, 310-11 (2004). In interpreting the suitability rule, we have stated that a registered representative's "recommendations must be consistent with his customer's best interests." Sathianathan, 89 SEC Docket at 782; Belden, 56 S.E.C. 496, 503 (2003); Jack H. Stein, 56 S.E.C. 108, 113 (2003); Daniel Richard Howard, 55 S.E.C. 1096, 1100 (2002), aff'd, 77 Fed. Appx. 2 (1st Cir. 2003).

25/ NASD Notice to Members 95-80 (Sept. 26, 1995).

soon mature into Class D shares with lower operating expenses and a resultant increase in yield. Instead, by convincing these customers to switch mutual funds, Epstein disrupted their original investment's holding period and eliminated the availability of a lower expense ratio.

Epstein does not argue, and the record does not suggest, that Epstein had reasonable grounds for believing that such recommendations were suitable for his customers based on their other security holdings and their financial situation and needs. The record shows that Epstein's mutual fund switch recommendations served his own interest by generating substantial production credits, but did not serve the interests of his customers. Epstein abdicated his responsibility for fair dealing when he put his own self-interest ahead of the interests of his customers. 26/

B. NASD Conduct Rule 2310(b) requires that, prior to the execution of a transaction recommended to a customer, a registered representative "make reasonable efforts to obtain information" concerning the customer's financial status, tax status, investment objectives, and any other information "used or considered to be reasonable" by the registered representative in making recommendations to a customer. We have stated previously that a registered representative must "tailor his recommendations to the customer's financial profile and investment objectives." 27/ NASD Notice 95-80 states that the "starting point" of a mutual fund recommendation is "to clearly define the investor's objectives and financial situation." 28/ FINRA advises registered representatives who sell mutual funds to "ask the investor what are his or her investment goals and objectives, including the investor's time horizon." 29/ In addition, NASD Notice to Members No. 94-16 states that a registered representative who sells "funds to elderly, retired, or first-time investors must have an adequate and reasonable basis for selling a particular fund to the investor." 30/

Epstein did not make reasonable efforts to update or verify the information in the Merrill Lynch databases concerning his customers' financial circumstances. Epstein's failure to do so was particularly problematic here because of the asserted unreliability of the FAC computer system. Indeed, Epstein's conversations with most of these customers were too brief – ranging

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26/ See Kenneth C. Krull, 53 S.E.C. 1101, 1111 (1998) (finding that respondent "placed his own interests in garnering commissions above those of his customers"), aff'd, 248 F.3d 907 (9th Cir. 2001).

27/ F.J. Kaufman & Co., 50 S.E.C. 164, 168 (1989).

28/ NASD Notice to Members 95-80.

29/ Suitability Issues for Multi-Class Mutual Funds, NASD Regulatory and Compliance Alert (Summer 2000).

30/ NASD Notice to Members 94-16 (Mar. 1994).

from around four minutes to twenty minutes – to permit a meaningful discussion of their financial situation. Although these were the first conversations that Epstein was having with them, he did not probe the customers' tolerance for risk or assess their investment objectives. In some cases, Epstein did not even make any pretense of gathering information, but rather, after noting the yield on the customer's investment, immediately pressed the customer to make a mutual fund switch.

In many cases, Epstein did not discuss with the customer the investment objectives, strategy, and risks associated with the particular mutual fund he was recommending, nor did he disclose the different classes of shares available for investment and their advantages and disadvantages. Krasner testified that Epstein "failed right across the board to discuss the operations costs of each of these classes of mutual fund." Krasner testified that "these clients, for the most part, did not receive sufficient information from Mr. Epstein to make a judgment as to whether the switches were suitable." The record therefore demonstrates that Epstein did not make reasonable efforts to obtain information concerning the customers' financial status, tax status, investment objectives, or any other information that might be considered reasonable when he recommended that they switch mutual funds, nor did he discuss with them the pros and cons of the recommended switches.

C. Epstein complains that the Hearing Officer's decision permitted the "Roberts letter, only tape-recordings of her telephone conversation with Epstein, and the tape-recordings of the other customers' conversations with Epstein, to be introduced into evidence without hearing from any witnesses." Epstein argues that "acceptance of the letter and recordings without witness testimony" deprived him of his "right to cross-examination of these witnesses." Moreover, according to Epstein, FINRA was "required to justify their failure to produce any customer witnesses, in violation of" NASD Rule 9253. 31/

NASD Rule 9253 imposes no such requirement. NASD Rule 9253 merely permits a respondent to request the production of witness statements pertaining to direct witness testimony. Moreover, it is well-established that hearsay evidence is admissible in administrative proceedings and can provide the basis for findings of violation, regardless of whether the declarants testify. 32/ We have held that "hearsay statements may be admitted in evidence and, in an

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31/ Epstein also cites to Commission Rule of Practice 235, 17 C.F.R. § 201.235, which governs the introduction of prior sworn statements of witnesses into the record of Commission-instituted administrative proceedings. That rule does not apply to FINRA proceedings. See infra note 54.

32/ See, e.g., David C. Ho, Exchange Act Rel. No. 54481 (Sept. 22, 2006), 88 SEC Docket 3194, 3206 ("We have long held that hearsay evidence is admissible in administrative proceedings"), aff'd, 2007 U.S. App. LEXIS 9882 (Apr. 18, 2007) (unpublished); Robert Fitzpatrick, 55 S.E.C. 419, 433 (2001) (citing Otto v. SEC, 253 F.3d 960, 966 (7th Cir.

(continued...)

appropriate case, may form the basis for findings of fact." 33/ In determining whether to rely on hearsay evidence, "it is necessary to evaluate its probative value and reliability, and the fairness of its use." 34/ The factors to consider include "the possible bias of the declarant, the type of hearsay at issue, whether the statements are signed and sworn to rather than anonymous, oral or unsworn, whether the statements are contradicted by direct testimony, whether the declarant was available to testify, and whether the hearsay is corroborated." 35/

We believe that the hearsay evidence at issue meets sufficient criteria to establish that it is reliable and probative. Under the circumstances of this case, we see no unfairness in the use of such evidence. We have found violations of NASD's suitability rules previously without the benefit of live testimony from customers. 36/ While the Commission has indicated that customer testimony may be the "most compelling evidence" in certain cases, it "is not essential" if the relevant information can be obtained from other sources in the record. 37/ The extensive recordings and transcripts of the conversations between Epstein and the customers, relevant customer account statements, and expert and other testimony at the hearing, among other things, evidence the switch recommendations that Epstein made to the customers. There is no indication, nor does Epstein allege, that any of the customers was biased. Several of the customers executed declarations which, although unsworn, were made under the penalty of perjury. 38/ We have stated previously that "other indicia, such as declarations, could be used"

32/ (...continued)
2001)). See also Charles D. Tom, 50 S.E.C. 1142, 1145 (1992) (setting forth test for admission of hearsay evidence).

33/ Tom, 50 S.E.C. at 1145.

34/ Id.

35/ Id.

36/ Cf. Sathianathan, 89 SEC Docket 774 (finding, among other things, that associated person of member firm made unsuitable mutual fund recommendations to customers).

37/ Canady, 54 S.E.C. 65, 76 ("supporting evidence need not be limited to customer testimony, but also may include testimony by the salesperson, other firm personnel, customer affidavits or even customer correspondence"). Cf. Michael David Sweeney, 50 S.E.C. 761, 767 (1991) (finding excessive trading in the absence of customer testimony where the relevant information was "readily available").

38/ See 28 U.S.C. § 1746, which generally treats an unsworn declaration as the equivalent of a sworn declaration, provided that the unsworn declaration is in writing, is signed and dated, and is subcribed by the declarant as true under penalty of perjury. See also Tom, 50 S.E.C. at 1145 (stating that, although a customer declaration was unsworn, "it averred
(continued...)

as they were here, "to provide sufficient evidence" to establish the violations at issue. 39/ Those customer declarations are corroborated by record evidence. Moreover, many of the customers were elderly and NASD does not have the authority to compel customers to appear at a hearing before it. Based on the totality of the evidence before us, we find that the absence of customer testimony at the hearing does not require a result different from FINRA's conclusion and that Epstein's actions in making the recommendations at issue violated NASD Rules 2310(a), 2310(b), IM-2310-2, and 2110.

IV.

Epstein's appeal is focused on various claims of procedural deficiency. Epstein argues that these deficiencies effectively denied him due process and that, as a result, this proceeding should either be dismissed or the sanction set aside. Epstein's contentions can be grouped into three related categories: (1) that Epstein is the victim of selective prosecution and that the disciplinary proceeding against him was improperly instituted; (2) that FINRA staff failed to follow their own rules by, among other things, refusing to provide him with exculpatory evidence in their possession; and (3) that the Hearing Officer assigned to this case was biased against Epstein.

We note as an initial matter that it is well-established that self-regulatory organizations ("SROs") are not subject to the Constitution's due process requirements. 40/ However, the Exchange Act requires NASD to provide "fair procedure[s]" for its disciplinary actions, the standard we apply to these proceedings. 41/ As discussed below, the record does not support Epstein's claims of procedural deficiency or FINRA misconduct.

A. Epstein claims that he was "selectively prosecuted for being a 'whistle blower'" and "for submitting lengthy letters" concerning conditions at the FAC "to [then-NASD vice

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38/ (...continued)
that it was made under the penalty of perjury and for present purposes we consider it the equivalent of a sworn affidavit.").

39/ Joseph J. Barbato, 53 S.E.C. 1259, 1279 n.28 (1999). See also Sathianathan, 89 SEC Docket 774 (finding, despite absence of customer testimony, that respondent made unsuitable mutual fund recommendations).

40/ See, e.g., Desiderio v. NASD, 191 F.3d 198, 206-07 (2d Cir. 1999) (stating that constitutional requirements generally do not apply to NASD), cert. denied, 531 U.S. 1069 (2001). See also Mark H. Love, 57 S.E.C. 315, 322 n.13 ("We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements.").

41/ 15 U.S.C. § 78o-3(b)(8).

chairman] Mary Schapiro and to [FINRA counsel] in August and November 2004," i.e., before November 11, 2004, when FINRA filed its complaint against him. 42/

The record does not support Epstein's claim of improper selective prosecution. To establish such a claim, a petitioner must demonstrate that he was unfairly singled out for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right. 43/ No such showing was made here.

Nor does the record support Epstein's claim that this proceeding was instituted in retaliation for any efforts to alert regulators about misconduct at the FAC. FINRA commenced its investigation of Epstein when it received Rose Roberts's complaint letter in August 2002 concerning possible misconduct by Epstein. FINRA took Epstein's investigative testimony on October 10, 2003. The "whistle blower" letters at issue were prepared by Epstein's attorneys and sent in response to a May 2004 "Wells" letter from FINRA notifying Epstein of FINRA's intention to charge him with misconduct.

Epstein claims further that, in proceeding against him instead of Merrill Lynch management or many of the other ISAs whom he alleges engaged in similar practices, FINRA was acting to "protect[] its largest member." 44/ However, as Epstein concedes, NASD

42/ Epstein asserts that these letters contained information regarding "massive securities violations" at the FAC. For example, the letters referenced "the intensity of the [sales] competitions" at the FAC and the "involvement of [the Firm's] senior management" in promoting such contests, and also accused Merrill Lynch of "specifically set[ting] up" the FAC "to act as a 'bucket shop' or 'boiler room'" for the purpose of "the switching of customers from one mutual fund to another." As discussed below, we find nothing improper in FINRA's institution of this proceeding. Nor do we see the relevance to this proceeding of the federal and state statutes that Epstein cites. These whistle-blower statutes "do not purport to provide a defense in a disciplinary action or to estop NASD from taking disciplinary action consistent with its rules." Sathianathan, 89 SEC Docket at 788.

43/ United States v. Huff, 959 F.2d 731, 735 (8th Cir. 1992) (setting forth elements of selective prosecution claim). See also Eagletech Commc'ns, Inc., Exchange Act Rel. No. 54095 (July 5, 2006), 88 SEC Docket 1225, 1231 (same); Sathianathan, 89 SEC Docket at 788-89; D'Alessio, 56 S.E.C. 396, 426 (2003); Guevara, 54 S.E.C. 655, 665 (2000); Richard J. Puccio, 52 S.E.C. 1041, 1046 (1996).

44/ Epstein's assertion that other ISAs also engaged in misconduct but were not subject to disciplinary proceedings does not support his claim of improper selective prosecution. "NASD disciplinary proceedings are treated as an exercise of prosecutorial discretion." Schellenbach v. SEC, 989 F.2d 907, 912 (7th Cir. 1993). As such, "it is no defense that

(continued...)

disciplined Merrill Lynch. 45/ Epstein also alleges that, in bringing this proceeding, FINRA staff colluded improperly with senior Merrill Lynch executives, against whom Epstein had a pending arbitration proceeding. The record indicates, however, that Epstein did not file his arbitration claim against Merrill Lynch until July 28, 2004, again long after FINRA's investigation had begun. There is no evidence in the record suggesting any type of collusion between FINRA staff and Merrill Lynch executives; rather, Epstein's assertion is the sole basis for such claim of collusion.

B. Epstein contends that, after instituting this proceeding, FINRA staff failed to follow its own rules. 46/ In particular, Epstein claims that FINRA staff "fraudulently" concealed material evidence, obstructed justice, and abused their authority by concealing from him "material evidence necessary for his defense." Epstein complains that FINRA failed to produce documents relating to Merrill Lynch's culpability in the operation of the FAC and to its supervision of the registered representatives who worked there. Epstein contends that, because the Commission granted an earlier motion by him to adduce certain documents into evidence, "there is a strong likelihood that Epstein was unconstitutionally deprived of presenting evidence material to understanding" of his pressurized work environment, his poor training, and the lack

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44/ (...continued)
others in the industry may have been operating in a similarly illegal or improper manner." Patricia H. Smith, 52 S.E.C. 346, 348 n.8 (1995).

45/ See supra note 6. Epstein asserts that the sanctions imposed on Merrill Lynch are disproportionate to those imposed on Epstein. However, courts have held that sanctions are not to be compared. See Butz v. Glover Livestock Comm'n Co., Inc., 411 U.S. 182, 187 (1973); Geiger v. SEC, 363 F.3d 481, 488 (D.C. Cir. 2004). We have also observed that sanctions in settled cases may understate the sanctions that would be imposed in litigated cases because settled sanctions reflect pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary litigation. See, e.g., Dennis Todd Lloyd Gordon, Exchange Act Rel. No. 57655 (Apr. 11, 2008), 93 SEC Docket 5089, 5118 (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); Puccio, 52 S.E.C. at 1045 (Oct. 22, 1996) (same).

46/ Epstein complains that during the hearing, FINRA made a request pursuant to NASD Rule 8210, that Epstein appear and testify at the hearing in this matter. As noted, Epstein did not appear; however, he has not been charged with a violation of Rule 8210. We do not see any prejudice to Epstein.

of supervision that, he claims, contributed to his misconduct. 47/ Epstein misconstrues the Commission order. While the order stated that certain of the documents Epstein submitted "may be relevant to an assessment of the sanctions imposed by FINRA," and admitted them to avoid further delay in this appeal, the order made no finding that the evidence was material to a determination of Epstein's liability.

Our review of the record indicates that FINRA staff complied with its rules in its production of documents and other information in this proceeding. NASD Rule 9251 requires FINRA to make available to a respondent documents prepared or obtained in connection with the investigation that led to the institution of the disciplinary proceeding. 48/ FINRA counsel represented at the hearing that Epstein was "given every document [he] was entitled to under [NASD's] Code of Procedure" and that Epstein "received all the exhibits in these two binders [distributed to the hearing panel] as part of the process." FINRA counsel also represented that Epstein received "every shred of paper that we had in our investigative file pertaining to Scott Epstein" and "ha[d] fully received every document that we had that was discoverable in this case."

It appears from the record that FINRA staff provided Epstein with those documents and other information that relate directly to its investigation of him, including the discoverable documents in their investigative file, the revised schedule of relevant trades that they introduced at the hearing, the prospectuses for the relevant mutual funds, customer account information, and recordings of the telephone conversations between Epstein and the customers, among other exhibits.

Epstein objects that he was not provided with evidence relating to what FINRA counsel described as "other investigations involved in this matter which" were "non-public." For

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47/ See Order Granting in Part and Deferring in Part Motion for Reconsideration of Order Denying Motion for Introduction of Additional Evidence and for Other Relief, Admin. Proc. File No. 3-12933 (May 9, 2008). Those documents, which Epstein asserts he later obtained through his arbitration case against the Firm, include: (a) a Wells notice dated July 1, 2004 that was issued to Merrill Lynch; (b) Merrill Lynch's response to that Wells notice; (c) Merrill Lynch's Letter of Acceptance, Waiver and Consent; (d) a chart purporting to be Epstein's expert's analysis of trading blotter reports of mutual fund trades at the FAC; (e) a Merrill Lynch internal document entitled "FAC Investment Process"; (f) a Merrill Lynch internal document entitled "FAC Segmentation Review"; (h) several Merrill Lynch sales contest flyers and spreadsheets tabulating contest results; and (i) hard copies of a Merrill Lynch sales presentation involving the FAC. We consider the relevance of this evidence infra in Section V.

48/ These documents generally include requests for information from FINRA members and their associated persons pursuant to NASD Rule 8210, responses thereto, transcripts and transcript exhibits, and other documents obtained from persons not employed by NASD.

example, Epstein asserts that he was not provided with "material exculpatory and mitigating documents or a list of documents being withheld, including the 14 [on-the-record] transcripts of witness depositions taken by the [Department of Enforcement]" apparently compiled during FINRA's separate investigation of Merrill Lynch. Under NASD Rule 9251, NASD is required to produce only the investigatory file that led to Epstein's disciplinary proceeding. There is no evidence that these additional documents were relevant to this proceeding. 49/

Epstein asserts that FINRA staff prevented his developing a record regarding conditions at the FAC. However, his own actions, or failure to act, were largely responsible for this result. There is no indication that Epstein sought evidence regarding these matters from sources other than FINRA, such as from customers or other ISAs with whom he worked, or made a request pursuant to NASD Rule 9252 for information from Merrill Lynch. 50/ Nor did he choose to testify about them himself, despite the Hearing Officer's suggestion that he do so. 51/ We have stated previously that "the failure of a respondent to testify and adduce available evidence to meet the charges against him and show mitigating factors does not entitle him to have the proceedings reopened after the issuance of an adverse decision." 52/ Instead, "[p]ublic policy considerations favor the expeditious disposition of litigation, and a respondent cannot be

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49/ Epstein attached to his reply brief excerpts from two of the fourteen OTR transcripts. They were not a part of the record below, and he has not moved for their introduction pursuant to Rule 452 of our Rules of Practice. Rule of Practice 452 permits a party to adduce new evidence on appeal only if the moving party shows "with particularity" both (a) that the evidence is "material" and (b) that there were "reasonable grounds for failure to adduce such evidence previously." 17 C.F.R. § 201.452. The testimony excerpts relate to the particular witnesses' general dissatisfaction with the FAC's operation. They do not mention Epstein or his customers. They do not appear material, and we do not admit them into the record.

50/ As relevant here, NASD Rule 9252 requires a respondent who requests that NASD compel the production of documents or testimony at a hearing to: submit such request in writing to the Hearing Officer no later than twenty-one days before the hearing date; describe such documents or testimony with specificity; explain the materiality of the documents or testimony; describe the requesting party's previous efforts to obtain the documents or testimony through other means; and state whether the custodian of the documents or testimony is subject to NASD jurisdiction.

51/ Epstein asserts that he did not do so to avoid providing Merrill Lynch with his testimony in the arbitration. As mentioned, Epstein's counsel explained Epstein's absence from the hearing by stating that Epstein was "not [there at the time] because he [was] working."

52/ Kenneth W. Haver, CPA, Exchange Act Rel. No. 54824 (Nov. 28, 2006), 89 SEC Docket 1237, 1240 n.11 and accompanying text (Order Denying Motion to Reopen Proceeding or Vacate Suspension) (quoting David T. Fleischman, 43 S.E.C. 518, 522 (1967)).

permitted to gamble on one course of action and, upon an unfavorable decision, to try another course of action." 53/ Under the circumstances, we find that FINRA complied with its discovery requirements. 54/

C. Epstein contends that the Hearing Officer was "biased" against him and, as a result, made adverse rulings and conducted this proceeding in a manner that compromised Epstein's right to a fair hearing. 55/ Epstein alleges that the "extremely narrowed discovery and unreasonably limited rulings" to which he was subject were "done intentionally and with malicious [sic]." Adverse rulings, by themselves, generally do not establish improper bias. 56/ We have held previously that "bias by a hearing officer is disqualifying only when it stems from an extrajudicial source and results in a decision on the merits based on matters other than those

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53/ Ho, 88 SEC Docket at 3205 (citing Fleischman, 43 S.E.C.at 522).

54/ We previously deferred ruling on Epstein's motion for additional discovery. We now deny that motion. Epstein's invocation of Commission Rule of Practice 235 to adduce such evidence is misplaced; that rule applies to Commission-instituted administrative proceedings, not to our review of SRO disciplinary proceedings. Moreover, while the Commission has the authority to refer certain SRO matters to an administrative law judge for supplemental evidentiary hearings, such a referral is "an extraordinary ancillary procedure," which is "reserved for truly exceptional cases." Allen Mansfield, 47 S.E.C. 184, 185 & n.5 (1979). This proceeding does not meet that high threshold. Epstein is "entitled only to items 'material to his defense'" and "is not entitled to conduct a fishing expedition . . . in an effort to discover something that might assist him in his defense," Dan Adlai Druz, 52 S.E.C. 416, 428 (1995) (internal citations omitted), or "in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory." G.K. Scott & Co., Inc., 51 S.E.C. 961, 973 (1994), aff'd, 56 F.3d 1531 (D.C. Cir. 1995) (Table). As discussed below, the type of deficiencies in the record of which Epstein complains result from his, and his counsel's, decision not to participate in the FINRA hearing process. Under the circumstances, additional discovery at this stage would not be appropriate.

55/ At the hearing, Epstein's attorney moved to recuse the Hearing Officer for being a "part of" the alleged "skullduggery" that was occurring at the hearing and accused the Hearing Officer of making "some very, very unfortunate rulings in this case." The Hearing Officer denied Epstein's recusal motion.

56/ Cf. United States v. Azhocar, 581 F.2d 735, 739 (9th Cir. 1978) (stating, in a criminal case, that "[a]dverse rulings" by the trial judge "do not constitute the requisite bias or prejudice" warranting the assignment of the proceeding to another trial judge).

gleaned from participation in a case." 57/ There is no evidence to suggest that this standard was met or that the Hearing Officer's actions were motivated by anything other than what occurred in the course of the proceeding.

Epstein asserts that the schedule that the Hearing Officer set at the pre-hearing conference was so short that it prevented him from marshaling evidence and testimony to mount a proper defense, and thus deprived him of discovery in his arbitration case. We find no basis for Epstein's claims of "unreasoning and arbitrary insistence upon expeditiousness" by the Hearing Officer. 58/ NASD Rule 9235 authorizes a Hearing Officer "to do all things necessary and appropriate to discharge his or her duties," including "regulating the course of the hearing." At the March 11, 2005 pre-hearing conference, the Hearing Officer scheduled the hearing for the week of July 11, 2005. The Hearing Officer properly overruled Epstein's objection. 59/ Thus, Epstein had four months from the date of the prehearing conference, instead of the one year that he sought, to prepare for the hearing. We conclude that four months was an adequate time to prepare for the hearing because Epstein possessed the records that related directly to NASD's investigation of him, including, among other things, the discoverable documents in NASD's investigative file and the recordings of the telephone conversations between Epstein and his customers; moreover, Epstein presumably could have interviewed possible witnesses during this period, as he had all the relevant names.

Epstein also blames his counsel's premature departure from the FINRA hearing – and Epstein's resulting lack of representation during the hearing – on the Hearing Officer's "inflammatory" remarks, which Epstein's counsel viewed as a threat of "contempt." As a result, according to Epstein, his counsel felt compelled to leave the hearing before putting on a defense.

We believe that the Hearing Officer gave Epstein's counsel wide latitude to plead his case. For example, when Epstein missed the deadline for filing his answer to FINRA's complaint, the Hearing Officer resisted FINRA counsel's calls to hold Epstein in default, compromised with Epstein in extending the filing deadline (albeit not to Epstein's complete

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57/ Phlo Corp., Exchange Act Rel. No. 55562 (Mar. 30, 2007), 90 SEC Docket 1089, 1109 (citing United States v. Grinnell Corp., 384 U.S. 563, 583 (1966)).

58/ Richard W. Suter, 47 S.E.C. 951, 963 (1983).

59/ During that March 11, 2005 pre-hearing conference, Epstein's counsel refused to agree to a hearing date. When the Hearing Officer asked when Epstein would be available for the hearing, Epstein's counsel responded "Next March" – which was a year hence. When the Hearing Officer replied "No way we're going to do that," Epstein's counsel retorted, "I know that. I just wanted to hear you say it." When the Hearing Officer decided that he was "going to set this case for hearing for the week of July 11th in –," Epstein's counsel interrupted him to say that "I think I will probably be on vacation out to see my grandchildren on that date."

satisfaction), and when Epstein missed that deadline as well, did not penalize Epstein for filing the answer eight days after the extended deadline. When the Hearing Officer directed Epstein's counsel to focus on "whether the allegations in the complaint are proved by a preponderance of the evidence," Epstein's counsel insisted that he did not "have to comply with an order that will destroy my case. I don't have to do that." Nonetheless, the Hearing Officer repeatedly gave Epstein's counsel wide latitude in questioning an NASD staff witness, often overruled objections from opposing counsel, and permitted Epstein's counsel to extemporize at length about the alleged unfairness of the proceedings. 60/

The Hearing Officer eventually told Epstein's counsel that "[i]f you want to continue with that kind of conduct I am going to be forced to take sanctions which could include disqualifying you from representing Mr. Epstein." As the record shows, however, before the Hearing Officer made this statement, Epstein's counsel had used derogatory and highly inappropriate language to refer to a Merrill Lynch executive, brought an NASD witness to tears with his aggressive cross-examination, and occasionally resorted to "screaming."

Moreover, our de novo review, in which we have carefully considered all of the evidence in the case and the transcripts of the proceedings below, "dissipates even the possibility of unfairness." 61/ The conduct of the proceedings by the Hearing Officer did not justify the departure of Epstein's counsel. The departure was the decision and choice of Epstein and Epstein's agent, and any effect on the proceedings is solely their responsibility. In any event, the totality of the record before us presents Epstein's arguments and the basis for those arguments, and we do not have adequate grounds to conclude that the departure of Epstein's counsel caused any material prejudice to Epstein's position.

Epstein asserts that the Hearing Officer committed error by instructing FINRA staff what to write in their post-hearing brief so that he could "render a decision containing the appropriate findings of fact and conclusions of law that would be more difficult for Epstein to reverse on appeal." According to Epstein, this "further proves" the Hearing Officer's "bias toward Epstein." We disagree. The record demonstrates that the Hearing Officer resisted FINRA counsel's request for a default ruling "given Mr. Epstein's absence from this proceeding and his attorney's

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60/ See Pinchas, 54 S.E.C. at 347 (rejecting respondent's claims of bias on the part of the hearing panel and NASD staff and noting that the hearing panel repeatedly gave respondent "wide latitude" in questioning witnesses during the hearing). Despite these measures, when the Hearing Officer denied Epstein's counsel's motion to "call the Chief Hearing Officer's office" to determine whether the Hearing Officer could be recused, Epstein's counsel announced that he was leaving the hearing and told the hearing panel to "do what you feel you want to do in terms of their case. But I can't proceed under these circumstances." The record reflects that Epstein's counsel then "left the room" and "closed the door."

61/ Robert Tretiak, 56 S.E.C. 209, 232 (2003).

actions." Stating that "the law abhors a default," the Hearing Officer rejected "the easy way to do it" and instead advised that, "out of an abundance of caution and what I think is the just way to handle this case, is that we take a look at the evidence, evaluate it, and then determine whether you have by a preponderance of the evidence proved the charges." There is no prejudice here. It is not improper for a Hearing Officer to give guidance regarding what issues to brief in post-hearing submissions.

Epstein also claims that FINRA staff sought to prevent his access to documents discoverable in his arbitration case, which was pending at the time, prior to the FINRA disciplinary action by "unreasonably accelerat[ing] discovery and rush[ing] the [disciplinary] hearing." However, Epstein presents no evidence to support this claim and, as discussed, we see nothing unreasonable in the scheduling of discovery or the hearing. Moreover, we fail to see how Epstein's arbitration action or the conduct of the proceedings in that action is relevant to this proceeding.

V.

Section 19(e) of the Securities Exchange Act of 1934 provides that we may cancel, reduce, or require the remission of a sanction if we find the sanction excessive or oppressive. 62/ FINRA Sanction Guidelines (the "Guidelines") recommend imposition of a monetary sanction of between \$2,500 and \$75,000 for unsuitable recommendations and a suspension for a period of ten business days to one year. 63/ However, in egregious cases, the Guidelines urge consideration of a longer suspension (of up to one to two years) or a bar. 64/ The Guidelines also identify certain factors or considerations as affecting the sanctioning determination, including the number of transactions at issue, whether the misconduct resulted in the potential for a respondent's monetary gain, and the level of sophistication of the affected customer. 65/ Those factors support FINRA's sanctioning decision here.

Epstein's misconduct was egregious. The evidence demonstrates that Epstein violated the suitability rule with respect to numerous customers, nearly all of whom were elderly and, it

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62/ 15 U.S.C. § 78s(e)(2). Exchange Act Section 19(e) also requires that a sanction not impose an unnecessary or inappropriate burden on competition. Epstein does not claim, and the record does not show, that FINRA's action has imposed an undue burden on competition.

63/ FINRA Sanction Guidelines 99 (2007), available at http://www.finra.org/RegulatoryEnforcement/FINRAEnforcementMarketRegulation/FINRASanctionGuidelines/SalesPractices/index.htm.

64/ Id.

65/ Id. at 6-7.

appears, retired. In addition, several of the customers were relatively unsophisticated with respect to the applicable fee structures and other attributes of the funds at issue. Epstein exploited his customers' vulnerabilities in making recommendations that clearly were unsuitable for them.

In many cases, the mutual fund switches that Epstein recommended burdened the customers with higher expense ratios and triggered new CDSC holding periods. In some instances, he deprived them of the lower expenses to which they would have been entitled had they maintained their investments and their mutual fund holdings matured into less expensive share classes, for example, from Class B to Class D shares – sometimes missing such automatic conversion by a matter of weeks. Disrupting an existing holding period (or one that had already phased out) and restarting an entirely new CDSC holding period that would run for several years, particularly for an elderly customer who might not survive the new holding period, without sufficient countervailing justification, is inexcusable. These kinds of switches that triggered new CDSC holding periods may have burdened the customers with operating expenses for the rest of their lives. Where it might have been appropriate to do so, Epstein never offered customers the opportunity of free or less costly exchanges among funds within the same fund family. Instead Epstein's mutual fund switch recommendations were designed "to maximize his commissions rather than to establish an appropriate portfolio" for the customers. 66/ His repeated violations of the suitability rule, as detailed above, "warrant serious sanctions." 67/

Epstein challenges FINRA's determination to bar him as excessive. In support of a lesser sanction, he cites his young age and limited industry experience. 68/ Epstein also claims that the "severe circumstances under which" he worked at the FAC, including, among other things, the "high-pressured work environment" and the "extreme time pressure" placed on him with respect to the length of customer telephone calls, are mitigating. Citing his lack of disciplinary history and minimizing the seriousness of his actions, 69/ Epstein claims that FINRA's sanction deviates from the principle of "progressive discipline" and amounts to "punitive enforcement."

66/ Sathianathan, 89 SEC Docket at 783.

67/ Id.

68/ Epstein asserts that "never" has an "inexperienced young man out of college" been permanently barred and that a lifetime bar "should be imposed only in cases involving repeat offenders or upon those with experience and knowledge, or 'scienter.'"

69/ Epstein asserts that he did not do something as serious as "sell[ing] a mutual fund and buy[ing] a speculative stock on margin."

We disagree. Despite Epstein's "youth and inexperience," the record demonstrates that "his activities involved more than a mere mistake in judgment." 70/ While we have considered the documents that he submitted and do not dispute Epstein's claims regarding conditions at the FAC, we do not consider them mitigating. "Those who hold themselves out as professionals with specialized knowledge and skill to furnish guidance cannot be heard to claim youth or inexperience when faced with charges of violations . . . ." 71/ Indeed, "[y]outh or inexperience does not excuse a registered representative's duty to his clients." 72/ Nor can Epstein blame his violations on a lack of supervision. We have held repeatedly that a "respondent cannot shift his or her responsibility for compliance with an applicable requirement to a supervisor or to the NASD." 73/ Rather, "[p]articipants in the securities industry must take responsibility for compliance with regulatory requirements and cannot be excused for lack of knowledge, understanding, or appreciation of these requirements." 74/ Indeed, Epstein's efforts to blame his conduct on his working environment demonstrate his failure to accept responsibility for his own actions. 75/ Moreover, a "lack of disciplinary history is not a mitigating factor for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional." 76/

70/ T. Joseph Widman, 46 S.E.C. 260, 263 (1976).

71/ SEC v. Hasho, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992).

72/ Id.

73/ Kocherhans, 52 S.E.C. at 531; Patrick G. Keel, 51 S.E.C. 282, 287 (1993) (finding that respondent did not take responsibility for making unsuitable recommendations but blamed his supervisor and customers instead).

74/ Id.

75/ Epstein asserts that he "was 'singled out' to be served a disciplinary complaint while the 300 other ISA's [sic] similarly situated to Epstein, and executing similar transactions in customer accounts, were not." As discussed, Epstein offered no evidence to support this claim. In any event, we consistently have held that the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases. See Butz v. Glover Livestock Comm'n Co., Inc., 411 U.S. at 187; Geiger v. SEC, 363 F.3d at 488. See also D'Alessio, 56 S.E.C. at 427 (same); Robert A. Amato, 51 S.E.C. 316, 321 n.25 (1993).

76/ Phillippe N. Keyes, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801. See also Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006) (lack of disciplinary history not a mitigating factor). We also note, in this connection, that, as discussed, Epstein's failure to develop evidence regarding possible mitigation was due, in large measure, to his refusal to participate in this proceeding.

We agree with FINRA that Epstein's "demonstrated insouciance and indifference towards his responsibilities under NASD rules poses a serious risk to the investing public." Based on the record before us, we believe that there is an ample basis for us to conclude that Epstein poses a significant risk to investors and is unfit to be in the securities industry. 77/ Although Epstein has not been employed in the securities industry since his termination from Merrill Lynch, he has expressed an interest in reentering the industry. We believe that taking advantage of elderly investors for "pecuniary benefit," as Epstein did here, "necessitate[s] exclusion from the securities business for the protection of public investors." 78/ For all the reasons stated above, and based on our review of the record, we do not find the sanction imposed by FINRA against Epstein to be excessive or oppressive.

Accordingly, we sustain FINRA's findings of violation and the sanction it imposed against Epstein. An appropriate order will issue. 79/

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

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

77/ Cf. David M. Haber, 52 S.E.C. 201, 207 (1995) (barring respondent who had been enjoined for, among other things, stock manipulation using high-pressure sales tactics); Frank J. Custable, Jr., 51 S.E.C. 855, 863 (1993) (barring respondent for, among other things, deceptive sales practices).

78/ Ronald Earl Smits, 50 S.E.C. 1020, 1025 (1992).

79/ 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. 59328 / January 30, 2009

Admin. Proc. File No. 3-12933

In the Matter of the Application of

SCOTT EPSTEIN

c/o George L. Mahr, II
Mahr and Mahr, LLC
80 Main Street
P.O. Box 534
Madison, NJ 07940

For Review of Disciplinary Action Taken by

FINRA

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 FINRA against Scott Epstein be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro and Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59326 / January 30, 2009

Admin. Proc. File No. 3-13001

In the Matter of the Application of

MICHAEL STEGAWSKI
Capstone Partners, L.C.
3475 Lenox Road, Suite 400
Atlanta, GA 30326

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF ASSOCIATION ACTION DENYING WAIVER OF EXAMINATION REQUIREMENTS

Registered securities association denied a request by a member firm, on behalf of a former registered representative whose registration had lapsed, that the applicable qualification examination be waived and the representative be permitted to resume his license without requalifying by examination. Held, review proceeding dismissed.

APPEARANCES:

Michael Stegawski, pro se.

Marc Menchel, Alan B. Lawhead, and Jennifer C. Brooks, for Financial Industry Regulatory Authority, Inc.

Appeal filed: March 13, 2008
Last brief received: August 19, 2008

7 of 8

I.

Michael Stegawski ("Stegawski"), a former registered representative, seeks review of FINRA action. 1/ FINRA denied a request by member firm Capstone Partners, L.C. ("Capstone"), on behalf of Stegawski, for waiver of the qualification examination required by NASD Membership and Registration Rule 1031(c) and for reinstatement of his Series 7 (general securities representative) license, which had lapsed. We base our findings on an independent review of the record.

II.

In January 2004, Stegawski began working as a trainee for Morgan Stanley DW Inc. ("Morgan Stanley"). On March 26, 2004, he passed the Series 7 Examination and became registered as a general securities representative with Morgan Stanley. At or around the same time, Stegawski also passed the Series 31 (futures managed funds) Examination and the Series 66 (uniform combined state law) Examination. On July 20, 2004, Stegawski left Morgan Stanley and the firm terminated his registration. Under NASD Rule 1031(c), Stegawski had two years from his termination to reinstate his registration. 2/

In September 2004, Stegawski enrolled at Georgia State College of Law. During law school, Stegawski participated in an externship program with the Commission's Atlanta Regional Office from September through December 2005. In December 2005, Stegawski passed Level I of the Chartered Financial Analyst ("CFA") Program. On July 20, 2006, the applicable two-year period for the reinstatement of Stegawski's registration as a general securities representative expired without reactivation.

A. The 2006 Waiver Request

In October 2006, Stegawski became a legal assistant with Capstone and the Law Office of Gregory Bartko. Bartko is Capstone's chief executive officer. On November 7, 2006, Capstone filed a Uniform Application for Securities Industry Registration or Transfer ("Form U4") to

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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. ("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), 72 Fed. Reg. 42,190 (Aug. 1, 2007). Because the action here was taken after that date, we use the designation FINRA in this proceeding, except for certain events involving NASD that took place before the consolidation.

2/ See NASD Membership and Registration Rule 1031(c), NASD Manual at 3142 (2006 ed.) discussed, infra, at note 10 and accompanying text.

register Stegawski as a general securities representative with NASD. 3/ On December 6, 2006, Capstone applied, on Stegawski's behalf, for a waiver of the Series 7 Examination based on Stegawski's educational achievement, prior registration and experience in the securities industry, and regulatory experience with the Commission (the "2006 Waiver Request"). NASD's Department of Testing and Continuing Education (the "Department") denied the 2006 Waiver Request, concluding that a waiver was not warranted. In April 2007, the Waiver Subcommittee of the National Adjudicatory Council (the "Waiver Subcommittee") affirmed the Department's denial. Neither Capstone nor Stegawski appealed that decision to the Commission.

B. The 2007 Waiver Request

In November 2007, Stegawski passed the Series 24 (general securities principal) Examination. Stegawski states that he graduated from law school in December 2007 and, since that time, passed the Florida Bar Examination. On December 18, 2007, Capstone filed a second request, on Stegawski's behalf, for a waiver of the Series 7 Examination with FINRA (the "2007 Waiver Request"). The 2007 Waiver Request asserted claims similar to those in the 2006 Waiver Request, i.e., that Stegawski qualified for a waiver based on his Commission externship (which, he represented, involved investigations of alleged investment fraud and securities laws violations), completion of the Series 7, 66, and 31 qualification examinations in 2004, association with a FINRA member firm, bachelor's degree in finance, and completion of Level I of the CFA Program. The 2007 Waiver Request represented additionally that, since the filing of the 2006 Waiver Request, Stegawski has passed the Series 24 Examination; completed all law school course work (including "securities regulation, bankruptcy, federal taxation, security interests, corporations, agency and partnership, wills and trusts, and contracts") and would soon receive his law degree; and maintained employment with Capstone and the Law Office of Gregory Bartko. Capstone did not file a Form U4 on Stegawski's behalf, as required by FINRA's Qualification Examination Waiver Guidelines (the "Waiver Guidelines"), in connection with the 2007 Waiver Request. 4/ FINRA did not immediately rule on the 2007 Waiver Request.

On March 7, 2008, Stegawski filed an application for review with the Commission, claiming that FINRA staff had effectively denied his 2007 Waiver Request during phone conversations with him. Stegawski asserted that FINRA staff told him that they previously had decided the matter when FINRA denied his 2006 Waiver Request. In a letter dated March 17, 2008, FINRA informed Stegawski that its Waiver Guidelines require a Form U4 to be filed with any waiver request. The next day, Capstone submitted a Form U4 on Stegawski's behalf to the Central Registration Depository ("CRD"). On April 4, 2008, the Department denied the 2007 Waiver request, concluding that the application presented no basis for a waiver of the Series 7

3/ See supra note 1.

4/ FINRA Qualification Examination Waiver Guidelines, available at http://www.finra.org/RegistrationQualifications/BrokerGuidanceResponsibility/Qualifications/p010600 (last visited on Oct. 15, 2008).

Examination. On April 8, 2008. Stegawski appealed that decision to the Waiver Subcommittee, and on April 17, 2008, he submitted a statement to the Waiver Subcommittee in support of his appeal.

On May 12, 2008, the Waiver Subcommittee affirmed the Department's denial of the 2007 Waiver Request, determining the request did not meet the standards set forth in FINRA's Waiver Guidelines for a waiver of a qualification examination. The Waiver Subcommittee found that Stegawski's law degree lacked a "substantial emphasis on finance and investments" and he failed to submit a final transcript reflecting his graduation; that his Commission externship was not his "most recent employment" and lacked the "breadth of experience necessary" for an examination waiver; and that his "prior experience as a general securities representative was not substantial, [lasting] approximately four months." The Waiver Subcommittee also found that Stegawski's completion of the Series 24 Examination and Level I of the CFA Program did not "ensure the same breadth of knowledge of the securities laws and regulations as does completing the Series 7 Examination." In concluding, the Waiver Subcommittee stated that Stegawski should "re-familiarize [himself] with FINRA rules through the examination process and become familiar with the changes to the securities laws that have occurred since [he] last registered."

On May 28, 2008, Stegawski amended his March 7 application for Commission review to include the Department's decision to deny the 2007 Waiver Request and the Waiver Subcommittee's affirmance of that decision.

III.

We lacked jurisdiction to review Stegawski's original March 7 application because FINRA had not yet acted on the 2007 Waiver Request. 5/ However, we will consider Stegawski's amended petition to review the Waiver Subcommittee's decision, which constitutes FINRA's final action. We previously held that we have jurisdiction to review a denial of a waiver of a license examination because it, "in effect, constitutes a bar from . . . associating with any [FINRA] member." 6/

5/ See, e.g., Florence Sarah Pollard, Exchange Act Rel. No. 55978 (June 28, 2007), 90 SEC Docket 2909, 2910 (dismissing application for review for applicant's failure to exhaust administrative remedies); Jeffrey A. King, Exchange Act Rel. No 52571 (Oct. 7, 2005), 86 SEC Docket 1439, 1443 (emphasizing that we "will not consider an application for review if the applicant failed to follow NASD procedures").

6/ Gina M. Guzzone, 57 S.E.C. 592, 596 (2004).

Our review of FINRA's denial of a waiver request is governed by Section 19(f) of the Securities Exchange Act of 1934. 7/ Pursuant to that Section, we must dismiss Applicant's appeal if we find that the specific grounds on which FINRA based its action "exist in fact," the action is in accordance with FINRA rules, FINRA applied those rules in a manner consistent with the purposes of the Exchange Act, and the action does not impose an undue burden on competition. 8/

A. Specific Grounds Existed in Fact

An applicant seeking to register as a general securities representative generally must take and pass the Series 7 qualification examination. 9/ NASD Rule 1031(c) further requires that an individual, such as Stegawski, whose most recent registration as a representative or principal has been terminated for a period of two or more years immediately preceding the date of receipt by FINRA of a new application, must retake and pass the appropriate qualification examination. 10/ Under NASD Rule 1070(d), FINRA may waive the appropriate qualification examination requirement and accept other evidence of qualifications for registration "in exceptional cases and where good cause is shown." 11/

FINRA examines the merits of any waiver request based on its Waiver Guidelines, which list five categories of waiver requests. 12/ Capstone based its 2007 Waiver Request on four of these categories: educational achievement, continuing registration, regulatory experience, and overall securities industry experience. For each of the four bases upon which Capstone relied in seeking an examination waiver, FINRA applied the pertinent Waiver Guideline to the facts

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7/ 15 U.S.C. § 78s(f).

8/ Elliot M. Hershberg, Exchange Act Rel. No. 53145 (Jan. 18, 2006), 87 S.E.C. Docket 494, 497, aff'd, 210 F. App'x 125 (2d Cir. 2006) (unpublished). Stegawski does not claim, nor does the record show, that FINRA's action imposes an unnecessary or inappropriate burden on competition.

9/ NASD Membership and Registration Rule 1031(a); NASD Manual at 3142 (2006 ed.).

10/ NASD Membership and Registration Rule 1031(c); NASD Manual at 3142.

11/ NASD Membership and Registration Rule 1070(d), NASD Manual at 3151.

12/ NASD Notice to Members 04-59 (Aug. 2004), available at www.finra.org. Although the Waiver Guidelines are not FINRA rules approved by the Commission, they are issued by FINRA to "to assist member firms in recognizing situations where a solid basis exists for requesting a waiver." Waiver Guidelines, supra, note 4. We will treat them as relevant factors to consider and have previously reviewed NASD's application of its Waiver Guidelines with respect to an alleged filing error made by a member firm. Guzzone, 57 S.E.C. at 597.

presented by Capstone and contained in the CRD. 13/ Stegawski does not deny the existence of the facts FINRA used in reaching its decision to deny the 2007 Waiver Request; rather he disagrees with the conclusions FINRA drew from those facts. We conclude from our review of the record that the grounds on which FINRA based its decision to deny the waiver request exist in fact.

The Waiver Guidelines authorize granting waiver requests based on educational achievement to "persons who terminate their registrations and enroll in a master's program with a substantial emphasis on Finance and Investments." 14/ In order to qualify for a waiver under this provision of the Waiver Guidelines "[an] applicant must return to a member firm promptly after completing the course of study and furnish a copy of the course transcript with the waiver request." 15/

Stegawski contends that his legal studies and bachelor's degree demonstrate his "broad exposure" to the securities industry and qualify him for a waiver based on educational achievement. Stegawski states that he received a law degree and studied courses in "securities regulation, bankruptcy, federal taxation, security interests, corporations, agency and partnership, wills and trusts, and contracts." He also states that he earned a bachelor's degree in finance and completed Level I of the CFA Program.

As an initial matter, the degree programs and examinations Stegawski relies on do not meet the Guidelines' requirements because they are not master's degree programs. He has a bachelor's degree -- not a master's degree -- in finance. His law degree, while including some relevant subjects, does not appear to have a "substantial emphasis on Finance and Investments." Capstone further failed to provide a copy of Stegawski's law school transcript, as required by the Waiver Guidelines, showing completion of the courses he had taken and verification of his graduation. 16/

Capstone also based its 2007 Waiver Request on Stegawski's continuing registration with other regulatory authorities, citing Stegawski's externship with the Commission's Atlanta Regional Office from September 2005 until December 2005. The Waiver Guidelines permit

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13/ Since the Waiver Subcommittee issued its decision, FINRA has made minor changes to the Waiver Guidelines to accommodate the consolidation of regulatory functions of NASD and NYSE. See supra note 1. None of those changes are at issue here.

14/ Waiver Guidelines, supra, note 4.

15/ Id.

16/ Stegawski's assertion in his reply brief that FINRA never asked for a full transcript is without merit because he may not place the burden of complying with the Waiver Guidelines' requirements on FINRA.

FINRA to waive the examination requirement where an applicant's registration remained active with another regulatory authority during the time of inactivity with FINRA. As the Waiver Guidelines explain, "[i]f an individual becomes associated with a broker/dealer that is not a FINRA member, the CRD system is incapable of recognizing the continuance. These situations normally arise when a person transfers to a non-member broker/dealer that is a member of a national securities exchange, a bank municipal securities dealer, or intra-state securities firm." 17/ However, the record reflects that since July 20, 2004 (when his previous Series 7 license became inactive), Stegawski has not been registered with any other regulatory authority, and thus he does not qualify for this exception to the examination requirements. We find no basis for Stegawski's assertion that his Commission externship is relevant to this exception.

Stegawski also contends that he qualifies for a waiver based on the regulatory experience he obtained from his four-month Commission externship. The Waiver Guidelines permit FINRA to waive the examination requirement when an applicant's "most recent employment has been with a securities regulatory agency" and the applicant "was previously registered with a member firm." 18/ However, Stegawski's most recent employment was not with the Commission or another regulatory agency, as the Waiver Guidelines require, but with Capstone and the Law Office of Gregory Bartko. The Waiver Guidelines also instruct FINRA to "consider the scope of the regulatory experience in deciding the waiver request." 19/ Stegawski's experience with the Commission lasted four months, during which he states that he was a research assistant for the trial unit and "aided the Enforcement Division in the investigation of Securities Act violations." Based on the limited nature of Stegawski's duties and the short duration of his experience, we agree with FINRA's conclusion that Stegawski's regulatory experience did not "evidence the breadth of experience necessary to warrant a waiver" of the examination requirements. 20/

Capstone further based its waiver request on Stegawski's overall securities industry experience. The Guideline for a waiver of the qualification examination based on an applicant's overall securities industry experience lists six factors to be considered, four of which are applicable here: the length and quality of such experience; the specific registration requested and

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17/ Waiver Guidelines, supra, note 4.

18/ Id.

19/ Id.

20/ See Exch. Servs. Inc., 48 S.E.C. 210, 213 (1985) (stating that the Commission will not overturn an NASD decision to deny a waiver of the examination requirements unless it is arbitrary or capricious), aff'd, 797 F.2d 188 (4th Cir. 1986); Investors Disc. Corp., 48 S.E.C. 182, 189 (1985) (same).

the type of business applicant will conduct; previous registration history; and "other examinations taken by the applicant," such as those for the CFA Program. 21/

In making its determination, the Waiver Subcommittee specifically considered Stegawski's experience in the securities industry: his six months with Morgan Stanley (four of which were as a registered general securities representative); his four-month externship with the Commission; and his experience as a legal assistant for Capstone and the Law Office of Gregory Bartko. We agree with FINRA that Stegawski's four months of experience as a registered representative four years ago, his four-month Commission externship three years ago, and his current position as a legal assistant do not provide adequate assurance that he currently possesses the knowledge of FINRA's rules required to act as a general securities representative. 22/ The Waiver Subcommittee also considered that Stegawski passed Level I examination of the CFA Program, the Series 24 Examination, and the Florida Bar Examination, in addition to his legal studies. However, the Waiver Subcommittee concluded that the fact that Stegawski passed these examinations and earned a law degree "does not ensure the same breadth of knowledge of the securities laws and regulations as does completing the Series 7 examination."

Stegawski argues that his experience demonstrates "knowledge far in excess of the minimum competency requirements of the Series 7 examination." However, none of the evidence Capstone proffered demonstrates that Stegawski has current knowledge of, and experience with, the wide range of products that the Series 7 Examination qualifies an individual to sell. For example, a Series 7 license allows individuals to sell "corporate securities, municipal securities, municipal fund securities, options, direct participation programs, investment company products, and variable contracts." 23/ FINRA may accept other evidence of an individual's knowledge of these product areas, besides a passing grade on the Series 7 Examination, but Stegawski has not made such a showing here.

Stegawski asserts that, because he passed the Series 24 Examination qualifying him to supervise general securities representatives, he also is competent to act as a general securities representative without reexamination. Contrary to Stegawski's assertions, the Series 24 Examination is not a substitute for the Series 7 Examination. The Series 24 Examination serves a separate regulatory purpose emphasizing a principal's obligations to supervise the operations of a general securities broker-dealer and its employees. As FINRA states, moreover, the Series 24

21/ Waiver Guidelines, supra, note 4.

22/ Although Stegawski also relies on his experience with Capstone and the Law Office of Gregory Bartko to support his waiver request, the information contained in his most recent Form U4 does not establish that his current employment is investment related.

23/ FINRA Registration and Examination Requirements, available at http://www.finra.org/RegistrationQualifications/BrokerGuidanceResponsibility/Qualifications/p011051 (last visited on Oct. 15, 2008).

Examination does not cover all the product areas tested on the Series 7 Examination. To the extent that Stegawski argues, relying on a discussion in Jon G. Symon, 24/ that NASD commonly grants a conditional waivers of the representative examination to individuals who pass the principal's examination, his argument is misplaced. Unlike Symon, where the individual seeking a waiver had thirty-one years of investment-related experience, Stegawski has not demonstrated substantial investment-related experience.

Accordingly, we find that specific grounds on which FINRA based its denial of the 2007 Waiver Request exist in fact.

B. Waiver Denial was in Accordance with FINRA Rules

The procedures FINRA followed in conducting its review of the 2007 Waiver Request were in accordance with its rules. The 9600 Series of NASD's Procedural Rules set forth the process for applicants to request an exemption from FINRA examination requirements. 25/ In connection with those rules, the Waiver Guidelines provide direction to member firms regarding the appropriate steps to follow when requesting an examination waiver.

Before submitting the 2007 Waiver Request, Capstone failed to "submit a [Form U4] electronically via the CRD system," as required by the Waiver Guidelines. 26/ After Capstone filed the requisite Form U4, the Department rendered a written decision on April 4, 2008, in accordance with NASD Procedural Rule 9620. On April 8, 2008, Stegawski filed a timely appeal of the Department's decision to the Waiver Subcommittee. The Waiver Subcommittee gave Stegawski an opportunity to provide a detailed explanation for the basis of his appeal, including a statement as to which of the Department's findings and conclusions he took exception. On April 17, 2008, Stegawski submitted what he described as "a detailed explanation for the basis of [his] appeal" to the Waiver Subcommittee. On May 12, 2008, the Waiver Subcommittee issued a

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24/ 54 S.E.C. 102, 110 (1999) (stating, in affirming NASD's denial of an unconditional waiver of the principal's examination, that "[w]hile he might be eligible for a conditional waiver that would exempt him from the requirement that he take the representative examination, he is not seeking such relief").

25/ NASD Procedural Rules 9610-9630; NASD Manual at 7399-7400. As of December 15, 2008, FINRA renamed NASD Rules 9610-9630 to FINRA Rules 9610-9630 without substantive change. See Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 FR 57174 (Oct. 1, 2008).

26/ Waiver Guidelines, supra, note 4.

written decision denying the 2007 Waiver Request. 27/ We find FINRA's review of Stegawski's request for an examination waiver complied with NASD's Rules.

C. Rules Applied were Consistent with Exchange Act's Purposes

FINRA also applied its rules in a manner consistent with the purposes of the Exchange Act. Exchange Act Section 15(b)(7) authorizes the Commission to regulate persons associated with broker-dealers by establishing qualification standards. 28/ Among such standards, Exchange Act Rule 15b7-1 requires associated persons to "pass[] any required examinations" established by the rules of the self-regulatory organizations." 29/ In adopting Rule 15b7-1, we stated that "[self-regulatory organization] qualification of associated persons of broker-dealers is of substantial importance in promoting compliance with the substantive requirements of the federal securities laws" and that the Commission principally relies on self-regulatory organizations "in the formulation and administration of qualification standards subject to [our] review and oversight." 30/

As discussed above, NASD Rule 1031(c) requires persons whose registrations have expired without reactivation for a period of two or more years to retake the appropriate qualifying examinations in order to reinstate their licenses. Stegawski has not functioned in the capacity of a general securities representative for over four years, when he did so for only a few months. We believe it is consistent with the policies of the Exchange Act to conclude that, in that time, there have been changes to the securities laws and regulations with which Stegawski should become familiar. As we have previously observed, requiring Stegawski to retake the qualification examination for the Series 7 license is fully consistent with the Exchange Act's statutory goal of ensuring the requisite levels of knowledge and competency of associated persons. 31/

27/ In August 2004, we approved FINRA's decision to create the Waiver Subcommittee to preside over appeals of examination waiver requests as a means of providing expedited review. Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. To Amend the Rule 9600 Series, Exchange Act Rel. No. 50099 (Aug. 3, 2004), 83 SEC Docket 1474.

28/ 15 U.S.C. § 78*o*(b)(7).

29/ 17 C.F.R. § 240.15b7-1.

30/ Requirement of Broker-Dealers to Comply with SRO Qualification Standards, Exchange Act Rel. No. 32261 (May 4, 1993), 54 SEC Docket 39, 40.

31/ Guzzone, 57 S.E.C. at 599 & n.17 (citing Symon, 54 S.E.C. at 110).

Stegawski asserts that FINRA, in denying the 2007 Waiver Request, is unfairly penalizing him for attending law school and attempting to "expand[] his knowledge of the securities industry." We disagree. Requiring requalification by examination is not punitive, but rather a safeguard to ensure that a representative possesses the requisite levels of knowledge and competency after a prior registration has expired. 32/ Four years have passed since Stegawski last served as a general securities representative. Given the public interest in ensuring that registered representatives are knowledgeable and competent in the products they sell, we find that, in requiring Stegawski to retake and pass the Series 7 Examination, FINRA applied its registration and waiver rules in a manner that was consistent with and advanced the purposes of the Exchange Act.

We, therefore, find that FINRA properly denied the 2007 Waiver Request. Accordingly, based on the foregoing, we dismiss this appeal.

An appropriate order will issue. 33/

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

Elizabeth M. Murphy
Secretary

By: J. Lynn Taylor
Assistant Secretary

32/ See Hans N. Beerbaum, Exchange Act Rel. No. 55731 (May 9, 2007), 90 SEC Docket 1863, 1869 n.17 (stating that "NASD's registration requirement provides an important safeguard in protecting public investors, and strict adherence to that requirement is essential because it serves a significant purpose in policing of the securities markets and in protection of the public interest") (internal punctuation omitted) (quoting Michael F. Flannigan, 56 S.E.C. 8, 17 (2003)).

33/ 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. 59326 / January 30, 2009

Admin. Proc. File No. 3-13001

In the Matter of the Application of

MICHAEL STEGAWSKI
Capstone Partners, L.C.
3475 Lenox Road, Suite 400
Atlanta, GA 30326

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDING

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

ORDERED that the application for review filed by Michael Stegawski, be, and it hereby is, dismissed.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Chairman Schapiro and Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59325 / January 30, 2009

Admin. Proc. File No. 3-12994

In the Matter of the Application of

CMG INSTITUTIONAL TRADING, LLC
and
SHAWN D. BALDWIN
c/o Nicole C. Patton, Esq.
The Law Offices of Nicole C. Patton
P.O. Box 934
Matteson, IL 60443

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Violation of Conduct Rules

Failure to Provide Requested Information

Member of registered securities association and its president failed to provide complete and timely responses to requests for information. Held, association's findings of violation and sanction imposed are sustained.

APPEARANCES:

Nicole C. Patton, of the Law Offices of Nicole C. Patton, for CMG Institutional Trading, LLC, and Shawn D. Baldwin.

Marc Menchel, Alan Lawhead, and Andrew J. Love, for Financial Industry Regulatory Authority, Inc.

Appeal filed: March 19, 2008
Last brief received: June 23, 2008

I.

CMG Institutional Trading, LLC ("CMG"), a former NASD member firm, 1/ and Shawn D. Baldwin (collectively, the "Applicants"), the firm's president and chief executive officer, seek review of NASD disciplinary action. 2/ NASD found that Applicants violated NASD Procedural Rule 8210 and Conduct Rule 2110 by failing to respond completely to NASD requests for information. 3/ NASD suspended Applicants for two years and fined them $25,000 jointly and severally. We base our findings on an independent review of the record.

II.

A. Commission Inquiries

At all relevant times, CMG operated as a $5,000 introducing broker-dealer. 4/ In September 2005, Commission staff informed Baldwin that CMG had insufficient net capital under Rule 15c3-1 of the Securities Exchange Act of 1934 (the "Net Capital Rule"), by an estimated $44,025. 5/ In response, Baldwin promised to contribute $75,000 to cure the alleged net capital deficiency. In a letter dated October 13, 2005, Commission staff notified Baldwin that

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1/ On April 2, 2008, CMG's membership with NASD was canceled for failure to pay membership fees.

2/ 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. ("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), 72 FR 42,190 (Aug. 1, 2007) (SR-NASD-2007-053). Because the disciplinary action here was initiated before that date, we continue to use the designation NASD.

3/ FINRA recently revised and renumbered its Rules. See Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 FR 57,174 (Oct. 1, 2008). No substantive changes were made to either NASD Rule 8210 [new FINRA 8210] or NASD Rule 2110 [new FINRA Rule 2010] that are at issue here, discussed infra at III.

4/ "An introducing broker deals directly with the public and originates customer accounts." Paul Joseph Benz, Exchange Act Rel. No. 57046 (Jan. 14, 2005), 84 SEC Docket 2631, 2632 n.6 (citation omitted).

5/ 17 C.F.R. § 240.15c3-1 (requiring broker-dealers to maintain minimum levels of liquid assets, or net capital, at all times). Broker-dealers that never receive or hold customer funds or securities, or owe any customer funds or securities, may operate under a $5,000 net capital requirement. 17 C.F.R. § 240.15c3-1(a)(4)(vi).

they had not received confirmation of the promised deposit and asked Baldwin to provide "a deposit ticket or bank statement" and confirm that "any funds so contributed [were] . . . permanent capital of the firm." 6/

Beginning about October 17, 2005, CMG represented to Commission staff that the firm had received a $3 million contribution to CMG's net capital, an amount the staff found "unusually large . . . for a $5K broker-dealer." CMG listed on its balance sheet a $3 million asset "due from" FX Trading LLC ("FX Trading"), a foreign exchange dealer registered with the National Futures Association ("NFA") and the Commodity Futures Trading Commission ("CFTC"). CMG produced a corporate resolution designating the $3 million as permanent capital of the firm and a proprietary account of introducing broker agreement (or "PAIB Agreement") with FX Trading, which stated that CMG's assets in its FX Trading account would be used to meet CMG's net capital requirements.

At a meeting on October 20, 2005, Baldwin gave Commission staff a printout of an "account snapshot" from FX Trading's Web site showing $3 million in a CMG account at FX Trading identified as "Acct. ID: 140." Baldwin stated that the $3 million originated from his own funds. However, Commission staff was concerned that the account snapshot "appeared altered": the digits "didn't line up"; "it looked like they had an excessive digit in the 3 million equity figure"; and Chicago was misspelled in CMG's address. The staff also noted that the snapshot covered one day, October 5 to October 6, not the entire month, as requested; and the Internet identification located in the snapshot's footer differed from the Internet identification on other documents the staff obtained from FX Trading's Web site. The staff determined that there was insufficient evidence that the $3 million existed or that it was permanent capital of CMG.

On November 18, 2005, after Commission staff was unable to contact FX Trading to verify the existence of and balance in CMG's account, they sent Baldwin a second letter requesting that he substantiate the $3 million contribution by "a deposit ticket and bank statement." The letter stated that the staff had made several attempts to reach Baldwin, but Baldwin had not returned their phone calls. Commission staff also notified NFA about their difficulties contacting FX Trading. NFA suspended FX Trading's membership on November 21, 2005. 7/ On December 8, 2005, the United States District Court for the District of New Jersey ordered FX Trading's assets frozen at the CFTC's request. 8/

6/ See Net Capital Rule, Exchange Act Rel. No. 28927 (Feb. 28, 1991), 48 SEC Docket 493, 496 (emphasizing that "net capital . . . should be permanent capital and not merely a temporary infusion of funds from an affiliate or other sources").

7/ FX Trading, LLC, NFA Case No. 05-MRA-022 (Nov. 21, 2005).

8/ CFTC v. FX Trading, LLC, Civil Action No. 5-5-722 (JLL), 2005 U.S. Dist. LEXIS 40855 (D.N.J. Dec. 8, 2005).

B. NASD's 8210 Requests

NASD staff reviewed the documents Baldwin submitted to the Commission staff and had similar concerns with respect to Baldwin's claim that $3 million was properly included in CMG's permanent capital. On November 29, 2005, NASD sent Applicants a written request, pursuant to NASD Rule 8210, requiring them to provide:

> 1. Copies of bank statements or account statements evidencing the source of funds for the $3 million balance held at FX Trading in the name of [CMG]. The statements requested should encompass the period July through October 2005.
>
> 2. Copies of all statements for [CMG's] account 140 [at FX Trading] . . . for the period July through October 2005.
>
> 3. Copies of all agreements, resolutions, minutes, etc., characterizing the funds as a loan or contribution to [CMG].

NASD required a response by December 7, 2005, stating that "[f]ailure to respond to th[e] request with the documentation or information requested may result in a disciplinary action."

NASD did not receive a response by the deadline. On December 7, it ordered CMG to cease conducting its securities business for failure to "verif[y] purported capital infusions . . . demonstrat[ing] it is currently in net capital compliance."

The following day, NASD staff made an unannounced visit to CMG's office, hand-delivering a second written request for information with respect to the $3 million contribution. Kila Weaver, a registered principal of CMG, told NASD staff that Baldwin was out of town and that she was not authorized to access the requested documents because they were locked in Baldwin's office. Weaver told NASD staff she would speak with Baldwin and fax the documents to them later in the day. Also on that day, Phillip Harris, an NASD supervisor of examiners, sent a facsimile to Weaver stating that NASD's initial "[Rule] 8210 request remain[ed] in effect" and that "if an extension is needed to provide a complete response, contact to [sic] me to arrange a reasonable production date." NASD did not receive any documents that day.

C. Applicants' Response to NASD's 8210 Requests

Within a short period, Baldwin left a total of eight voice mail messages with Harris and another member of NASD's examination staff. In the messages, Baldwin voiced frustration with NASD's inquiry into CMG's compliance with the net capital requirements, NASD's inquiry into the source of $3 million capital contribution, and NASD's suspension of CMG's broker-dealer operations. With respect to the $3 million capital contribution, Baldwin stated in one message:

> [T]he $3 million came from an account from me. That's at FX. Prior to . . . that is, quite frankly, none of your business. It came from another account from me, but I'm not going to share that with you because I don't think you've been the most scrupulous of people. So I'll send you the account information that I have at FX, and I will send you the account information for [CMG] and you'll see that it comes from the Shawn Baldwin account to CMG.

In a letter to NASD dated December 13, 2005, Baldwin represented that CMG had "complied completed [sic] with every request" and had "demonstrated [CMG] exceed[ed its] net capital requirement." Baldwin stated: "We have established that the $3 million capital contribution made by me on October 6 to CMG . . . [was] immaterial to the firm's compliance with the net capital rule," and that CMG had "submitted all supporting documents for [the] net capital computation including bank statements, check detail, commission reports, escrow account statements, etc." Baldwin attached no documents to the December 13 letter, gave no further explanation of the source of the $3 million capital contribution or why he believed it was now immaterial, and concluded in the letter that "[i]f there are no further requests, I require that you give us written confirmation and contact our clearing firm to confirm that we are in net capital compliance and are free to conduct securities business."

On December 15, 2005, Baldwin and his attorneys met with Commission and NASD staff to discuss the status of the $3 million capital contribution and of CMG's FX Trading account. During the meeting, Baldwin represented for the first time that the $3 million contribution came from an unidentified "foundation," which he refused to name, asserting it was confidential. Baldwin explained that FX Trading account documents were unavailable and that he would have the documents delivered at a later date. Baldwin also informed Commission and NASD staff that CMG had removed an earlier deposit of $100,000 from its net capital account based on concerns from Commission staff that those funds also lacked documentation.

On December 21, 2005, CMG, through its attorneys, sent Commission staff a memorandum regarding CMG's net capital and the $3 million. CMG attached to the December 21 memorandum: (1) a demand note for $3 million payable to Amaranth Holdings (the foundation Baldwin previously refused to name) from Capital Management Group Securities, Inc. ("CMG Securities"), a separate entity from CMG; 9/ (2) a written guaranty signed by Baldwin, in his capacity as chief executive officer ("CEO") and president of CMG Securities, guaranteeing repayment of the loan from Amaranth Holdings; and (3) the identical one-page account snapshot from FX Trading's Web site that Baldwin provided the Commission staff in October 2005. The memorandum stated that Baldwin had been unsuccessful in obtaining "additional information from Amaranth Holdings regarding the transfer of the $3,000,000 from Amaranth Holdings ultimately to CMG's account at FX Trading." The memorandum stated that "it appears that FX Trading has suspended CMG's access to its online account. As such, CMG has been unable to access its online account information" to demonstrate the balance in the FX Trading account.

9/ CMG Securities is not an NASD member.

CMG did not send the memorandum and the attached documents to NASD, but Commission staff forwarded a copy to NASD.

C. NASD Proceedings

On April 17, 2006, NASD brought disciplinary action against CMG and Baldwin for their failure to provide information to NASD staff. In testimony before NASD's Hearing Panel, Baldwin admitted that Applicants never provided documents responsive to the first two items listed in NASD's November 29 letter:

> Q: [I]t says the request . . . [is] asking you to provide copies of the bank statements evidencing the source for the $3 million balance held at FX Trading in the name of CMG Institutional Trading, LLC, and that the statements requested should encompass the period July through October, 2005. . . . Were any of those statements provided, sir?
>
> A [Baldwin]: No, they were not.
>
> Q: It also asks for copies of all statements for account 140 referenced for the same period . . . . Did you provide any copies of those statements?
>
> A [Baldwin]: No, we did not.

Baldwin explained he was unable to obtain the account statements from FX Trading because FX Trading "never mailed [him] a statement [and] no one answered their phone." Baldwin testified that he was unsure whether he or CMG's attorneys notified NASD of this problem at the time of its information request.

Contrary to his first assertion to NASD that the $3 million came from his funds, Baldwin initially testified that Amaranth Holdings loaned the money to CMG Securities. In turn, CMG Securities deposited the funds into Baldwin's personal FX Trading account and Baldwin then transferred those funds to CMG's FX Trading account. However, later, in response to questions from the Hearing Panel, Baldwin testified that he never had a personal account at FX Trading and that CMG Securities transferred the money directly to CMG. Baldwin also suggested that FX Trading, not Amaranth Holdings, made the loan to CMG Securities. 10/

Baldwin also testified that CMG "oftentimes get[s] suspended for being out of net capital compliance . . . ." For example, NASD discovered a net capital deficiency during an on-site examination of CMG in July 2005.

10/ Although the relationship between Amaranth Holdings and FX Trading was not established, it appears from the record they had at least one principal in common.

The Hearing Panel found that Applicants violated NASD Rules 8210 and 2110 by failing to respond to NASD's requests for information with respect to the source and status of the claimed $3 million capital contribution. The Hearing Panel expelled CMG from NASD membership and barred Baldwin from associating with any member firm. On appeal, the National Adjudicatory Council ("NAC") reduced the sanctions from bars to suspensions for two years because it found that Baldwin provided some information at the December 15 meeting and additional information a week later. The NAC also found that Baldwin "generally informed [NASD] that he was having difficulty obtaining documents." 11/

III.

Pursuant to Section 19(e)(1) of the Securities Exchange Act of 1934, we will sustain NASD's disciplinary action if the record shows that Applicants engaged in the violative conduct that NASD found and that NASD applied its rules in a manner consistent with the purposes of the Exchange Act. 12/ Based on our de novo review of the record, we find that a preponderance of the evidence supports NASD's finding of violations against Applicants.

NASD Rule 8210 requires member firms and their associated persons to provide information to NASD in the course of an investigation. 13/ We have stressed the importance of Rule 8210 in connection with NASD's "obligation to police the activities of its members and associated persons." 14/ Without subpoena power, NASD must rely on Rule 8210 to obtain information from its members necessary to carry out its investigations and fulfill its regulatory mandate. 15/ Member firms and associated persons violate Rule 8210 when they fail to provide full and prompt cooperation to NASD in response to an NASD request for information. 16/

11/ The NAC affirmed the Hearing Panel's dismissal of a separate charge under NASD Rule 8210 that Applicants failed to respond to NASD information requests in connection with NASD's exit conference following its on-site examination in July 2005.

12/ 15 U.S.C. § 78s(e)(1).

13/ NASD Procedural Rule 8210(a), NASD Manual at 7211 (2003 ed.).

14/ PAZ Sec., Inc., Exchange Act Rel. No. 57656 (Apr. 11, 2008), 93 SEC Docket 5122, 5127 (internal quotations omitted), appeal filed, No. 08-1188 (D.C. Cir. May 13, 2008).

15/ Perpetual Sec. Inc, Exchange Act Rel. No. 56613, 91 SEC Docket 2489, 2502-03 (quoting Rooney A. Sahai, Exchange Act Rel. No. 51549 (Apr. 15, 2005), 85 SEC Docket 862, 873 n.24) (internal quotations omitted).

16/ Ashton Noshir Gowadia, 53 S.E.C. 786, 793 (1998); see also Brian L. Gibbons, 52 S.E.C. 791, 794 (1996), aff'd, 112 F.3d 516 (9th Cir. 1997) (Table).

The Net Capital Rule serves as "the principal regulatory tool by which the Commission and [the self-regulatory organizations] monitor the financial health of brokerage firms and protect customers from the risks involved in leaving their cash and securities with broker-dealers." 17/ Baldwin testified that CMG had on other occasions been suspended for net capital deficiencies. On November 29, 2005, NASD requested that Applicants verify both the amount and source of a capital contribution purportedly made to cure CMG's net capital deficiency. 18/ The November 29 letter sought bank and account statements from July through October 2005 evidencing the source of the purported $3 million capital contribution, and monthly statements for CMG's "account 140" at FX Trading from July through October 2005. Baldwin admitted at hearing that Applicants never provided NASD with materials responsive to these requests.

Nonetheless, Applicants assert that they "fully and exhaustively complied" with NASD's inquiries "by December 21, 2005." Applicants cite three pieces of correspondence: a December 8 letter from Weaver requesting "clarification of the documentation that [NASD] was seeking"; a December 9 transmittal letter from Weaver "regarding whether the firm was in net capital compliance" and seeking an extension to NASD's request; 19/ and a December 12 letter from Baldwin regarding a separate $50,000 capital contribution to CMG. None of these documents were admitted before the Hearing Panel or the NAC. Applicants have not sought to admit the documents before us. 20/ Even if we determined to admit these letters, we would attach little weight. Both the December 9 and December 12 letters are unsigned, and Weaver, who purportedly authored two of the letters, did not testify before the Hearing Panel. Moreover, none of these letters provides the missing statements evidencing the source of the claimed $3 million in funds or monthly account statements for the FX Trading account.

In their briefs, Applicants also claim to have "hand-delivered notarized documentation" at the December 15 meeting showing the "loan process for the $3,000,000; sources of capital; and

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17/ Touche Ross & Co. v. Redington, 442 U.S. 560, 570 (1979).

18/ NASD found that the staff received CMG's corporate resolution from October 6, 2005, as evidence that the funds were a capital contribution.

19/ The December 9 letter purports to transmit CMG's net capital computations for October and November and the resolution confirming the capital contribution. None of the attachments are included in Applicants' submission. As noted above, NASD found that Applicants provided the corporate resolution.

20/ See 17 C.F.R. § 201.460(c) (providing that documents not admitted at hearing "shall not be considered a part of the record before the Commission"). We may admit additional evidence on a party's motion pursuant to Rule of Practice 452, but the movant "must show with particularity that the evidence is material and that there were reasonable grounds for the failure to adduce such evidence previously." 17 C.F.R. § 201.452. Applicants have not made such a motion.

entities involved in the transaction." Again, the documents that Applicants cite were not admitted in the NASD proceeding. Both documents are dated December 15, 2005, and represent that the $3 million originated from Baldwin's personal account at FX Trading. This assertion is inconsistent with both Baldwin's statement at the December 15 meeting that the funds came from an unnamed "foundation" and his subsequent hearing testimony. 21/

At the hearing, Baldwin provided additional details about the $3 million capital contribution, including the movement of the funds to CMG's account at FX Trading and the problems he experienced in obtaining the materials requested. However, even at this stage, Baldwin's response was incomplete and inconsistent. The NAC found his hearing testimony "raised even more questions," and that had he responded this way in a timely manner, NASD "would have likely sought additional information." In any event, we have emphasized repeatedly that NASD should not have to initiate a disciplinary action to elicit a response to its information requests made pursuant to Rule 8210. 22/

Although Applicants claim full compliance, their actions exhibited an unwillingness to respond fully to NASD. Applicants never provided statements for the period requested. In Baldwin's voice mail messages to Harris on or around December 7, Baldwin stated bluntly that the information requested was "none of your business" and that "I'm not going to share that with you because I don't believe you've been the most scrupulous of people." Applicants' December 13 letter to NASD provided no documents and declared that the information NASD requested was "immaterial to the firm's compliance with the net capital rule." However, NASD member firms and their associated persons "may not ignore NASD inquiries; nor take it upon themselves to determine whether information is material to an NASD investigation of their conduct." 23/ Rather, a member firm and its associated persons have an obligation to respond to NASD's requests fully and promptly. 24/

21/ At various times in their briefs, Applicants obliquely refer to a January 4, 2006, memorandum from CMG to the Commission as responsive to NASD's requests. While the January 4 memorandum appears to contain some additional FX Trading account information not provided earlier, none of the materials satisfies NASD's request for "statements for the period July through October 2005." It is unclear when NASD received this memorandum.

22/ E.g., Toni Valentino, 57 S.E.C. 330, 339 & n.14 (2004) (citing Robert A. Quiel, 53 S.E.C. 165, 168 (1997)).

23/ Gen. Bond & Share Co. v. SEC, 39 F.3d 1451, 1461 (10th Cir. 1994) (affirming Commission's finding that member violated predecessor rule to NASD Rule 8210).

24/ Charles C. Fawcett, IV, Exchange Act Rel. No. 56770 (Nov. 8, 2007), 91 SEC Docket 3147, 3158 & n.33 (citing Joseph G. Chiulli, 54 S.E.C. 515, 524 (2000) (stating that, by

(continued...)

Applicants assert that, between November 29 and December 15, Baldwin "repeatedly informed" NASD that "he was attempting to get the documents from FX Trading." However, the record reflects that Baldwin first informed NASD that FX Trading documents were unavailable to him at the December 15 meeting. He gave no further details of his efforts to obtain the information or the problems he encountered, only that he would send documents to NASD later. In the December 21 memorandum, Applicants merely stated that they could not access their online account with FX Trading. The memorandum did not explain their efforts to obtain the requested information or why, as account holders, they did not possess hard copies of the statements. While Applicants provided various loan documents with the December 21 memorandum, they failed to explain how the proceeds from the loan came into CMG's possession, as NASD had requested. 25/

We have held that an NASD member or an associated person has an obligation beyond a mere statement that the records are unavailable: "if such a person cannot readily provide the information sought by NASD, such a person ha[s] an obligation to explain, as completely as possible, his efforts, and his inability to do so." 26/ The information NASD requested on November 29 was the same information Commission staff had sought at various times from Applicants since October 2005. If they did not have the information, Applicants had a responsibility to provide a detailed explanation of their efforts to date to obtain the information requested and the problems they encountered. Applicants cannot fulfill their obligation to provide information by giving cursory and untimely explanations about the unavailability of

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24/ (...continued)
registering with NASD, applicant "agreed to abide by its rules which are unequivocal with respect to an associated person's duty to cooperate with NASD investigations")).

25/ The record reflects that NASD was not the intended recipient of the December 21 memorandum; rather it was directed to Commission staff. Baldwin explained that CMG addressed Commission staff first because the firm was receiving multiple requests for information from both the Commission and NASD. The Commission and NASD are separate and distinct entities; Applicants' obligation to provide the Commission with records upon its request, pursuant to Exchange Act Section 17(a)(1), 15 U.S.C. § 78q(a)(1), is independent of their obligation to respond to NASD's requests made pursuant to NASD Rule 8210.

26/ Perpetual, 91 SEC Docket at 2504 (internal quotations omitted); see also Rooney A. Sahai, Exchange Act Rel. No. 55046 (Jan. 5, 2007), 89 SEC Docket 2402, 2407 ("[W]e would have expected . . . Sahai to [have] detail[ed] his efforts to obtain the information requested. Sahai stated only that he had searched his files and found no further documents."); Quiel, 53 S.E.C. at 168 ("[E]ven if Quiel could not access readily the information that the NASD requested, we find he failed to explain the deficiencies in his responses or answer as completely as he was able.").

documents. 27/ Applicants suggest that the court-ordered freezing of FX Trading's assets on December 8 impacted the availability of the requested documents. Applicants, however, do not explain why they could not obtain the materials before the December 8 freeze order or how the freeze of assets prevented access to the records. If Applicants had a problem meeting the deadline set by NASD, they should have "raised, discussed, and resolved [it] with the NASD staff in the cooperative spirit and prompt manner contemplated by the Rules." 28/

Applicants contend that loan documents for the $3 million and the FX Trading records that NASD requested were not in their possession or control, relying on Jay Alan Ochanpaugh. 29/ They argue that the loans were made to Baldwin and CMG Securities, not to CMG, and that the FX Trading account belonged to CMG Securities. As an initial matter, Applicants' argument that the FX Trading account in question was set up in CMG Securities' name is inaccurate. NASD's request sought statements from "account 140" at FX Trading, which, according to the account snapshot Baldwin provided, was held in CMG's name. Moreover, unlike in Ochanpaugh, Baldwin failed to establish that he did not have access to and control over responsive documents in possession of CMG Securities since he was that firm's CEO and president. Further, as an associated person of a member firm, Baldwin was required to provide NASD with any documents that belonged to him personally. 30/

Applicants assert that NASD abused its discretion in requesting information because neither NASD nor Commission staff "had any proof" that the FX Trading account snapshot "was altered or fake" or that the $3 million "did not exist." NASD Rule 8210(a) has no requirement that NASD explain its reasons for making the information request or justify its relevance. 31/ We

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27/ Perpetual, 91 SEC Docket at 2504 & n.48 (citing Sahai, 85 SEC Docket at 872).

28/ Richard J. Rouse, 51 S.E.C. 581, 584 n.9 (1993).

29/ Exchange Act Rel. No. 54363 (Aug. 25, 2006), 88 SEC Docket 2653 (finding that associated person did not have control over documents sought by NASD pursuant to Rule 8210).

30/ NASD Rule 8210(a) (requiring associated persons to provide NASD with their "books, records, and accounts"). In Ochanpaugh, 88 SEC Docket at 2661, we further noted that "[t]here may be circumstances in which possession and control of documents . . . together with some other interest in the documents short of an ownership interest, may be sufficient [to extend Rule 8210 to documents that may belong to a third party] given the enforcement objectives of the NASD."

31/ Morton Bruce Erenstein, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3120 & n.10 (citing Sahai, 89 SEC Docket at 2406), petition denied, No. 07-15736 (11th Cir. 2008).

have held repeatedly that members and their associated persons may not "second guess" NASD's requests for information or "set conditions on their compliance." 32/ In any event, given CMG's history of net capital deficiencies and apparent discrepancies in the account snapshot, NASD had ample reason to seek additional information. 33/

Applicants claim that NASD examiners ignored evidence of a separate $100,000 capital contribution that proved CMG was in compliance with its net capital requirements and that, in doing so, examiners exhibited "inherent bias against [] Baldwin." Applicants are not charged with violating the Net Capital Rule. The relevant inquiry here is whether Applicants provided documents or information responsive to NASD's requests at issue. With respect to Applicants' charge that NASD's actions were improperly motivated by an "inherent bias" against Baldwin, Applicants supplied no evidence to substantiate this claim and we find no support in the record. 34/

Applicants argue that portions of the NAC's decision further support a conclusion that they did not violate NASD Rules 8210 and 2110, stating that the NAC noted that NASD staff presented "confusing and contradictory" testimony and the NAC was "'troubled' by the testimony of the [NASD] staff and their 'inability' to recall when they were in receipt of the documents that may in fact have complied with their requests." The portions of the NAC decision cited concern information requests that are no longer at issue. 35/ With respect to the requests at issue, there is ample evidence, including Baldwin's testimony, that Applicants did not respond fully.

32/ E.g., Pearson, 89 SEC Docket at 1635; Hannan, 53 S.E.C. at 859.

33/ Applicants further assert that NASD has a "duty to support [its] members during their compliance activities" and that NASD failed this duty by providing Applicants with only a brief period of time, eight days, in which to respond to NASD's information request. Applicants, however, "cannot shift their burden of compliance to NASD." Hans N. Beerbaum, Exchange Act Rel. No. 55731 (May 9, 2007), 90 SEC 1863, 1871 n.22 (citing B.R. Stickle & Co., 51 S.E.C. 1022, 1025 (1994)).

34/ To the extent that Baldwin is making a claim of selective prosecution against NASD, he must establish that he was part of a protected class under the Equal Protection Clause, "that prosecutors acted with bad intent, [and] that similarly situated individuals outside the protected category were not prosecuted." Fog Cutter Capital Group Inc. v. SEC, 474 F.3d 822, 826 (D.C. Cir. 2007) (internal punctuation omitted) (quoting United States v. Armstrong, 517 U.S. 456, 465 (1996)). Baldwin has not attempted to make such a showing.

35/ The portions of the NAC decision cited concern the second charge that the NAC dismissed and the receipt of the corporate resolution in response to the third category of information requested by NASD's November 29 letter. See supra notes 11 and 18.

Accordingly, we find that Applicants violated NASD Rules 8210 and 2110 by failing to respond completely and in a timely manner to NASD's November 29 request for information. 36/

IV.

Pursuant to Exchange Act Section 19(e)(2), we sustain NASD's sanction unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 37/ Finding Applicants' misconduct to be serious violations of NASD rules, NASD suspended Applicants for two years and fined them jointly and severally $25,000. We sustain NASD sanctions because they are neither excessive nor oppressive in light of Applicants' misconduct and they will serve the public interest and the protection of investors.

We observe that the sanctions imposed by NASD are consistent with NASD's Sanction Guidelines. 38/ The Sanction Guidelines provide, for violations of NASD Rules 2110 and 8210 involving failure to respond completely to an information request, that NASD should consider suspending an individual in any or all capacities, or the firm in any or all activities or functions, for up to two years and fining the individual or firm up to $25,000. The Guideline provides two "Principal Considerations" when determining the appropriate sanction: (1) the nature of the information requested; and (2) whether the requested information has been provided and, if so, the number of requests made, the time respondent took to respond, and the degree of regulatory pressure required to obtain a response. 39/ Application of these considerations suggests that Applicants should be sanctioned at the high end of the sanction recommendation.

The information NASD requested was important. The Net Capital Rule is a fundamental rule governing the operations of broker-dealers. The principle purposes of the rule "are to protect customers and other market participants from broker-dealer failures and to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the

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36/ NASD Conduct Rule 2110 requires members and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade." NASD Manual at 4111, 7211 (2003 ed.). A violation of NASD Rule 8210 is also a violation of NASD Rule 2110. Stephen J. Gluckman, 54 S.E.C. 175, 185 (1999).

37/ 15 U.S.C. § 78s(e)(2). Applicants do not claim, nor does the record show, that NASD's action imposed an unnecessary or inappropriate burden on competition.

38/ Although the Commission is not bound by the Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2). Perpetual, 91 SEC Docket at 2506 n.56 (stating that NASD promulgated the Sanction Guidelines in an effort to achieve greater consistency, uniformity, and fairness in its sanctions).

39/ NASD Sanction Guidelines at 35 (2006 ed.).

need for a formal proceeding or financial assistance from the Securities Investor Protection Corporation." 40/ As we have held, "[e]nsuring compliance with the net capital rule is important to protect investors from the possible financial collapse of a firm." 41/ While a $5,000 introducing broker-dealer, such as CMG, is precluded under the Net Capital Rule from holding or receiving customer funds or securities, 42/ its collapse can nonetheless expose investors to pecuniary loss, including leaving its customers "unable to liquidate their securities positions [with the clearing firm] or open new positions until their accounts are transferred to another broker-dealer." 43/

Prior to NASD's information request, Commission staff notified Applicants of their concern with the adequacy of CMG's capitalization. In requesting that Applicants verify an unusual capital contribution in light of CMG's net capital deficiency, NASD sought to protect investors from possible financial loss and potentially injurious conduct. Rather than promptly responding to NASD's request, Applicants cooperated minimally in the weeks that followed, raising further concern that CMG was undercapitalized and that CMG might not be entitled to the $3 million.

Applicants' failure to meet the December 7 deadline required NASD to order CMG to cease doing business and to make additional requests for the information, which included an on-site visit by NASD staff. Applicants eventually gave incomplete and inconsistent answers, and they admit to never having provided information responsive to two categories of information at

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40/ Fox & Co. Invs., Inc., Exchange Act Rel. No. 52697 (Oct. 28, 2005), 86 SEC Docket 1895, 1903 & n.20 (citing Lowell H. Listrom, 50 S.E.C. 883, 886 (1992), aff'd, 975 F.2d 866 (8th Cir. 1992) (Table)); see also Blaise D'Antoni & Assocs., Inc. v. SEC, 289 F.2d 276, 277 (5th Cir. 1961) ("By limiting the ratio of a broker's indebtedness to his capital, the rule operates to assure confidence and safety to the investing public.").

41/ PAZ, 93 SEC Docket at 5130.

42/ 17 C.F.R. § 240.15c3-1(a)(4)(vi).

43/ Net Capital Rule, Exchange Act Rel. No. 31512 (Nov. 24, 1992), 52 SEC Docket 4167, 4169-70 (explaining that clearing firms generally will not accept orders from the introducing firm's customers). Introducing firms also have indirect access to customer funds and securities, and can direct the movement of such assets by placing orders with clearing firms. By requiring introducing firms to maintain specific levels of liquid assets, the Net Capital Rule helps ensure the financial integrity of introducing firms and thereby protects investors. Id.; see also Self-Regulatory Organizations; Cincinnati Stock Exchange Inc., Order Granting Approval to Proposed Rule Change Increasing Net Capital Requirements, Exchange Act Rel. No. 39245 (Oct. 16, 1997), 65 SEC Docket 2227, 2227 (noting that an introducing "firm with sufficient net capital may be less likely to attempt to convert" customer assets it controls at the clearing firm to its own benefit).

issue here. Applicants' failure to give complete and timely responses prevented NASD from fully and expeditiously determining the firm's financial stability and whether misconduct had occurred. 44/

Applicants argue that the sanctions imposed by the NAC are excessive, suggesting that their lack of disciplinary history is mitigating. While the existence of a disciplinary history may serve to enhance the sanction imposed, the "[l]ack of disciplinary history is not a mitigating factor." 45/ As we have repeatedly held, member firms and their associated persons "should not be rewarded for acting in accordance with [their] duties." 46/

Applicants also argue as mitigating that "no investors were harmed nor was there any crime or fraud perpetrated on the public." We have stated, however, that "a Rule 8210 violation will rarely, in itself, result in direct harm to a customer." 47/ The purpose of the rule is to give NASD, in the absence of subpoena power, the ability to detect misconduct among its members and associated persons in the interest of protecting investors and the integrity of the markets. Even if no separate disciplinary action results from NASD's underlying investigation, a failure to cooperate during that investigation threatens the self-regulatory system and, in turn, investors by impeding NASD's detection of violative conduct. 48/

Applicants assert further in mitigation that they had no "retail clients, only institutions and qualified institutional buyers." NASD Rule 8210 does not lessen one's obligation to cooperate with an investigation based on the type of client served, nor are sophisticated or institutional investors without the need for protection against potential financial instability. 49/

44/ See Mark Allen Elliot, 51 S.E.C. 1148, 1151 (1994) (stating that a failure to provide requested information fully and promptly "subverts NASD's ability to carry out its regulatory responsibilities"); John A. Malach, 51 S.E.C. 618, 621 (1993) (same).

45/ Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006); see also General Principle No. 2, NASD Sanction Guidelines at 2 (2006 ed.) (permitting consideration of relevant disciplinary history for imposing sanctions "beyond those outlined in the[] guidelines" but not recommending mitigation when there is an absence of disciplinary history).

46/ E.g., Philippe N. Keyes, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801 (citing Daniel D. Manoff, 55 S.E.C. 1155, 1165-66 & n.15 (2002) (collecting cases)).

47/ PAZ, 93 SEC Docket at 5129.

48/ Id.

49/ Cf., e.g., Dolphin and Bradbury, Inc., Exchange Act Rel. No. 54143 (July 13, 2006), 88 SEC Docket 1298, 1314 (stating that "the protection of the antifraud provisions of the

(continued...)

We find that the sanctions NASD imposed are appropriate in the public interest and are remedial. As NASD concluded in its sanction determination, Applicants' misconduct was serious because "it subverted [NASD]'s ability to carry out its self-regulatory functions, including its ability to protect investors by ensuring that member firms comply with net capital requirements." 50/ Applicants' untimely and incomplete responses to NASD's inquiry regarding the sufficiency of its net capital put investors at risk because NASD was unable to determine timely if CMG had adequate capital to protect investors from the possibility of the firm's failure. 51/ The sanctions NASD imposed will encourage Applicants, upon the lifting of their suspensions, as well as encourage others already in the industry, to respond to NASD information requests completely and in a timely manner. 52/

Accordingly, we find NASD's decision to suspend Applicants in all capacities for two years and impose a $25,000 joint-and-several fine neither "excessive or oppressive" within the meaning of Exchange Act Section 19(e).

An appropriate order will issue. 53/

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

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

49/ (...continued)
securities laws extends to sophisticated investors as well as those less sophisticated"), aff'd, 512 F.3d 634 (D.C. Cir. 2008).

50/ See also Barry C. Wilson, 52 S.E.C. 1070, 1075 (1996) ("Delay and neglect on the part of members and their associated persons [in responding to 8210 requests] undermine the ability of the NASD to conduct investigations and thereby protect the public interest.").

51/ See supra note 43 and accompanying text.

52/ Although "'general deterrence is not, by itself, sufficient justification for expulsion or suspension[,] . . . it may be considered as part of the overall remedial inquiry.'" PAZ Sec., Inc., 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting McCarthy v. SEC, 406 F.3d 179, 189 (2d Cir. 2005)).

53/ 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. 59325 / January 30, 2009

Admin. Proc. File No. 3-12994

In the Matter of the Application of

CMG INSTITUTIONAL TRADING, LLC
and
SHAWN D. BALDWIN
c/o Nicole C. Patton, Esq.
The Law Offices of Nicole C. Patton
P.O. Box 934
Matteson, IL 60443

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY NASD

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

ORDERED that the disciplinary action taken by NASD against CMG Institutional Trading, LLC, and Shawn D. Baldwin, be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary